2

Theories of regulation

2.1 Introduction

A theory of regulation is a set of propositions or hypotheses about *why* regulation emerges, *which actors* contribute to that emergence and typical *patterns of interaction* between regulatory actors. In answering the 'why' question, we range beyond law to other disciplines, and much of the material in this chapter draws upon the disciplines of politics, economics and sociology. In order to understand the academic literature on this topic, it is helpful to bear in mind two core ideas, which help to differentiate the focus of theories of regulation. Firstly, some theories assume a relatively clear dividing line between public and private actors and institutions while others view the line as blurred both in theory and practice. Secondly, some theories focus mainly on economically defined goals, factors and influences, while others supplement this focus with attention to more broadly defined political goals, factors and influences. Somewhat less attention has been paid to the kinds of values and concerns which lawyers tend to emphasise in exploring the patterned emergence of regulation. The aims of this chapter are therefore twofold. Firstly, to guide the reader through the different theories of regulation, drawing out the contrasts between the roles they give to public and private actors and institutions, and the degree to which they incorporate efficiency-enhancing, redistributive and other broader social objectives. Secondly, to consider the facilitative role of law in theories of regulation and to introduce (within that role) the image of law as umpire. Because existing literature on theories of regulation is largely inattentive to the role of law, this aim will be achieved by drawing out the implications of the text extracts in commentary.

We have divided theories of regulation into three main categories: public interest theories, private interest theories and institutionalist theories. All three categories have in common a concern to uncover the processes that lead to the adoption of a particular regulatory regime. Where regulation is understood essentially as state intervention into the economy by making and applying legal rules, theories of regulation can be seen as an explanation of how and why legislative standards come about. Public interest and private interest theories

https://doi.org/10.1017/CBO9780511801112.003 Published online by Cambridge University Press

in particular can be approached as accounts of what happens to make government actors pass detailed rules that govern the conduct of private actors. But as Chapter 1 has emphasised, regulation scholarship is increasingly challenging the 'understanding' of regulation as state-enacted legal rules. As we shall see, private and other non-governmental actors play an increasingly important role in establishing and implementing regulation. Public interest theories of regulation attribute to legislators (and others responsible for the design and implementation of regulation) a desire to pursue collective goals with the aim of promoting the general welfare of the community. Private interest theories, by contrast, are skeptical of the so-called 'public interestedness' of legislators and policy-makers, recognising that regulation often benefits particular groups in society, and not always those it was ostensibly intended to benefit. Institutionalist theories tend to emphasise the interdependency of state and non-state actors in the pursuit of both public benefit and private gain within regulatory regimes. Although these theories originally focused on implementing regulation, they have powerful implications for uncovering the processes of how regulatory regimes emerge: implications which challenge divisions between public and private institutions or actors.

It is worth noting that theories of regulation often contain a mixture of explanatory and prescriptive elements, the former focusing on trying to *explain* why regulation emerges and the latter identifying the goal or goals which regulation *should* pursue. For example, some public interest theories of regulation may explain the emergence of regulation as a response to market failure, yet also *prescribe* regulation as the 'correct' response to market failure, because regulation should pursue the goal of achieving economic efficiency. By contrast, some private interest theories explain the emergence of regulation as a result of the pressure of private interest groups seeking to secure benefits for themselves. Some (but not all) private interest explanations may also be accompanied by a prescriptive assessment of whether the outcomes resulting from the processes they document are economically efficient. These examples suggest that we should not assume that public interest theories are prescriptive while private interest theories are explanatory. The inability to classify all public interest theories as prescriptive and all private interest theories as explanatory becomes more apparent once we examine theories of regulation that explicitly base their entire approach upon the potential fluidity of boundaries — both between public and private interest theories, and between explanatory and prescriptive motivations. Our third category of theory, which we loosely describe as 'institutionalist' approaches, highlights such fluidity. We will now proceed to explore these categories in more detail.

2.2 Public interest theories of regulation

Public interest theories of regulation, as stated above, attribute to legislators and others responsible for the design and implementation of regulation a desire to

pursue collective goals with the aim of promoting the general welfare of the community. They can be further subdivided into those that articulate regulatory goals in terms of economic efficiency and those which include other political goals.

2.2.1 Welfare economics approaches

The 'economic version' of public interest theory is probably the most well known. In simple terms, it suggests that regulation is a response to imperfections in the market known as 'market failures'. Correction of market failures increases the community's general welfare and is thus in the public interest. Correlatively, those who press for regulation in response to market failures are agents of the public interest. Market failures can be typically defined by categories of monopoly (and other anti-competitive behaviour), externalities, public goods and information asymmetries. Ogus provides a clear explanation of these various market failures in the following extract.

Anthony Ogus, '*Regulation*' (2004)

> We can see regulation as the necessary exercise of collective power through government in order to cure 'market failures' to protect the public from such evils as monopoly behavior, ''destructive'' competition, the abuse of private economic power, or the effects of externalities. Something like this account, explicitly or implicitly, underpins virtually all public-interest accounts of regulation. Regulation is justified because the regulatory regime can do what the market cannot. Where the regulatory regime works — produces market-correcting, general-interest policies — it should be left alone ... Any attempt to formulate a comprehensive list of public interest goals which may be used to justify regulation would be futile, since what constitutes the 'public interest' will vary according to time, place, and the specific values held by a particular society. In this [section], we shall nevertheless examine those [economic] goals which in modern Western societies have typically been asserted as reasons for collectivist measures, and which are derived from the perceived shortcomings of the market system. ... [We will] ... construe economic welfare in terms of allocative efficiency, a situation in which resources are put to their most valuable uses. ... [O]n certain key assumptions, the unrestricted interaction of market forces generates such efficiency. In the real world in many sets of circumstances these assumptions, notably adequate information, competition, and the absence of externalities, are not fulfilled — in short, there is 'market failure'. Many instances of market failure are remediable, in theory at least, by private law and thus by instrument which are compatible with the market system in the sense that collective action is not required. But ... private law cannot always provide an effective solution. Where, then, 'market failure' is accompanied by 'private law failure' ... there is a prima facie case for regulatory intervention in the public interest. It is important to stress that it is only a prima facie, and not a conclusive, case for such intervention. The reason is that either the regulatory solution may be no more successful in correcting the inefficiencies than the market or private law, or that

any efficiency gains to which it does give rise may be outweighed by increased transaction costs of misallocations created in other sectors of the economy. In other words, 'market failure' and 'private law failure' have to be compared with 'regulatory failure'.

Monopolies and natural monopolies

Competition is a crucial assumption of the market model. Where it is seriously impaired by monopolies and anti-competitive practices there is market failure. Competition (or antitrust) law is the principle instrument for dealing with this problem ... A 'natural monopoly' is a special kind of monopoly which calls for very different treatment. While the undesirable consequences (that goods are overpriced and under produced relative to their true social value) arise equally in relation to natural monopolies, the remedy for the latter lies not in competition. Rather, the monopoly is allowed to prevail; and some form of (economic) regulation is necessary to control those consequences.

A natural monopoly occurs where it is less costly to society for production to be carried out by one firm, rather than by several or many. In most industries there are economies of scale; since part of a firm's costs are fixed, it is proportionally cheaper to increase output. But this is normally true only up to a certain point, beyond which the marginal costs of a firm's production tend to rise. The classic instance of a natural monopoly is where the marginal costs – and hence also average costs – of a single firm's production continue, in the long run, to decline. The monopoly tends to develop 'naturally' as it becomes apparent that a single firm can supply the total output of an industry more cheaply than more than one firm. Such a situation typically occurs when fixed costs, that is, those that are necessarily incurred whatever the level of output, are high relative to demand. Thus, for example, the supply of electricity requires an enormous initial investment in plant and cables and so forth before even the smallest demand can be met. On the assumption that these fixed costs constitute a high proportion of the total costs of supply, than once the initial investment has been made, the average costs of additional units declines as more are produced.

Even if the marginal costs of production begin to rise at a certain point, thus giving rise to what is sometimes called a 'temporary' natural monopoly, there may be features in the market which still make it cheaper for one firm to produce the total output of an industry. For example, demand may vary considerably according to time and season – there are peak consumption periods of electricity during certain winter hours – and yet the supplier must respond instantaneously to the demand. A second feature, which applies particularly to systems of communication, is interdependence of demand. If one person wishes to speak by telephone to another, and/or receive calls from him, both must subscribe to the same network; there is clearly an economy of scale in a single network. Intuitively, too, it would seem that the duplication of facilities, for example and laying of railway tracks or the construction of grid systems, is itself wasteful and therefore economically to be avoided. The essence of the problem is, however, not the duplication itself – there is

such duplication in all competitive markets – but rather the ability, or inability, of the suppliers to achieve economies of scale through the use of a single set of facilities ....

Public goods

The second instance of market failure arises in relation to public goods. As its name would suggest, a public good is a commodity the benefit from which is shared by the public as a whole, or by some group within it. More specifically, it combines two characteristics: first, consumption by one person does not leave less for others to consume; and, a secondly, it is impossible or too costly for the supplier to exclude those who do not pay for the benefit. Take the often-cited example of a national defence system which provides collective security. That all citizens of Manchester will benefit from such a system will not diminish the benefit that will be enjoyed by citizens of Salford and it is not possible to prevent any citizens of Salford – say, one who does not pay his taxes – from the protection which the system provides. The example should make it obvious why the market method of allocation cannot be used to determine supply of a public good. Suppose a private firm offered to provide a community with protection according to the level of demand for such protection, as expressed by the willingness to pay. Each individual in the community would know that however much she was willing to pay for the protection would not affect the amount of protection actually supplied, because each would be able to benefit to the same degree however much she paid. If she paid nothing, she would still be able to 'free-ride'. Willingness to pay, in other words, cannot be used to measure demand and will thus fail to provide incentives for suppliers to produce.

National (or local) security is an example of a pure public good. Such goods are typically provided by suppliers which are publicly owned – in our example, the armed forces and the police. In fact this is not (economically) essential; a private firm could supply the good, but a public agency is required both to raise sufficient money to secure the supply and to make decisions determining the quantity and quality of the public good. The first of these functions must be carried out by a public institution because, to overcome the free-rider problem, it must have police power to impose taxes. The second requires the political authority to make decisions representing the will of the community, given that demand cannot be determined through individual preferences, as reflected in willingness to pay. However, that very inability to measure demand by reference to individual preferences makes it virtually impossible to devise 'rational' institutional structures for ascertaining the will of the community with any precision. If a policy-maker has to decide how much collective security to 'purchase', he should in theory ascertain the aggregate society demand by a summation of what all individuals within the community would be prepared, by way of taxes, to pay for it. Even if this information could be gathered at reasonable cost, it would be unreliable, since, given the free-rider problem referred to above, each individual would know that the amount which she stipulates that she is ready to pay would not affect the level of provision. Conventional democratic process

cannot fare much better. Voting in a referendum cannot reflect the intensity of preferences – each voter can say only 'yes' or 'no' to a proposed programme – and electing representatives of a legislature invariably involves expressing preferences between different packages of policies.

There are many commodities which, though not pure public goods, nevertheless contain some public good dimension – they are sometimes referred to as 'impure' public goods. Such goods may be supplied and bought in the market but, unless corrected by regulatory interventions, they are subject to a degree of market failure. Education and training constitute examples. Clearly the person who receives this commodity is the primary beneficiary and the price that she is willing to pay for it should, in theory at least, reflect that benefit, principally the increase to her earning capacity. But other members of society also gain from the provision of education and training. For example, there are assumed to be material gains to present and future generations from a better-trained workforce; education may encourage socially responsible behaviour and political stability through a more informed electorate; and – though these may be difficult to define and to locate – 'cultural heritage' may be enriched.

Granted the existence of these consequences, a misallocation of resources will result from the unfettered operation of the market: the price which suppliers are able to obtain will not reflect the true social value of the education and training and, in consequence, there will be underproduction. The simplest regulatory corrective is for the payment of a public subsidy which will reflect this divergence between the private value of the product and its social value. But the public good hypothesis may also provide a justification for other forms of intervention. If society derives a benefit from education and training over and above that acquired by the immediate recipient, then it also has an interest in the quality of the product, and that may justify subjecting the contract between supplier and purchaser to the imposition of public quality standards.

Other externalities

Public goods constitute one type of externality, a form of market failure [in which] if a producer's activity imposes costs on third parties that are not reflected (or 'internalised') in the prices which he charges for his products a misallocation of resources results: purchasers of the product do not pay for its true social cost and hence more units of the products are supplied than is socially appropriate. [P]rivate law instruments may fail to correct [this] misallocation. We must now explore some aspects of externalities and the problems that are posed for effective regulation. Much traditional analysis tends to concentrate on relatively simple examples of externalities: an industrial polluter imposing costs on a neighbouring landowner should be made to 'internalise' that cost – the 'polluter-pay principle' – by means either of private law (for example, an action in nuisance) or of regulation (imposing environmental standards or taxing discharges). But externalities may have widespread effects, leading to considerable complexities for policy-makers concerned to devise appropriate legal corrections. Suppose that the pollution involves irreversible

ecological changes, which have a presumed adverse impact only on future generations. The misallocation cannot be corrected by private legal instruments because of the time-lag in the private rights accruing. On public interest grounds, regulation may be called for. But, 'rationally', how is the appropriate level of intervention to be determined?

Take next the following example. A road bridge is poorly constructed and has to be closed for two weeks for repairs to be effected. Traffic is diverted through a peaceful village, causing disamenities to residents there; the congestion creates delays to road users leading to productivity losses and inconvenience; and businesses (e.g. a petrol station) adjacent to the bridge may lose custom during the two weeks. On the face of it, we have here a series of externalities requiring some form of correction. Typically when situations like this have generated private law claims for compensation they have been rejected, and judges and academic commentators have struggled in efforts to articulate policy and formulate principles justifying such conclusions. Regulatory systems faced with similar problems have not reached different solutions.

There are several reasons why it may be inappropriate to attempt to correct apparent externalities, such as those described. In the first place, the third party on whom the cost is imposed may have received *ex ante*, or will receive *ex post*, indirect compensation for the loss. In these circumstances, no misallocation occurs. The facts of the bridge case may be adapted to provide an illustration of *ex post* compensation. If the petrol station suffers short-term losses while the bridge is being repaired but gains in the long term from an increased traffic flow when improvements are complete, no intervention is required: in a rough and ready way, the external cost has been cancelled out by an external benefit. As regards *ex ante* compensation, suppose that I purchase property in the knowledge that a firm nearby is engaged in a polluting activity which will to some extent reduce the amenities attaching to my land. Rationally, I will pay less for the property then would otherwise have been the case. In such circumstances, the pollution does not constitute an externality, for the capital value of my purchase has not been depreciated; through the reduced price, the market has already taken account of the cost.

This pollution example also illustrates another problem in the definition of externalities, and this leads us to the second reason why a corrective measure may be inappropriate. We tend to envisage the externalities as unilaterally imposed by one person (or firm) on another. In fact the causation issue is more subtle and the policy implications, in consequence, more complex. It can be argued that the cost, the disamenity attaching to my land, is as much the result of my presence there as it is of the firm polluting the environment. No problem would, of course, arise if the firm did not pollute; but equally no problem would arise if I (or someone else) were not there to receive the pollution. Understood in this way, the language of 'externalities' disguises the basic nature of the problem, that there is a friction arising from the competing and conflicting claim of two parties (the firm and me) for use of a single resource — the atmosphere. How should the conflict be resolved? Applying the criterion of allocative efficiency, the economic answer is that the burden

of avoiding of eliminating the friction should be imposed on whichever of the parties can achieve this at lowest cost. If it costs the firm more to abate the pollution than for me not to locate my home in the vicinity, or to relocate if my purchase of the property predates the industrial activity, then economically it is inappropriate for the law, public or private, to restrain the pollution. Of course, for the purpose of this calculation, care must be taken to include all the costs arising from the avoidance or elimination of the friction. In the typical atmospheric pollution situation, large numbers (including possibly future generations) compete with the polluter for use of the environment, and, given the very high aggregate of their avoidance costs, abatement of the pollution will usually be the cheaper solution.

Thirdly, it is not appropriate on economic grounds to eliminate what are often referred to as 'pecuniary' externalities; these, unlike 'technological' externalities, do not give rise to a misallocation of resources. What we have hitherto considered as externalities are 'technological' externalities: they are harmful or beneficial effects on one party's productive activity or utility directly resulting from another party's behaviour. 'Pecuniary' externalities, on the other hand, are pure value (financial) changes borne by their parties which result from changes in technology or in consumer preferences. They involve indirect effects which alter the demand faced by the harmed or benefited third party. Pecuniary externalities are the result of the natural play of market forces. They involve wealth transfers which cancel out and not increases in the costs faced by society.

An example may help to clarify the important distinction. Alf is in the music-recording business; he sells tapes recorded in his studio. Celia, a neighbour, who manufactures widgets, installs new machinery which increases her productivity but is very noisy. Alf, as a result, has to add soundproofing to his studio. Bert markets a new recording device which is bought by some of Alf's competitors and enables them to sell tapes at a reduced price; in consequence, the demand for Alf's tapes drops dramatically. Alf purchases Bert's device to reduce his costs. Celia's noise is a technological externality since it increases social costs. Bert's device, on the other hand, while it may impose a loss on Alf, is a pecuniary externality: it does not add to social costs; rather, it enables resources to move to a more valuable use.

Finally, account must, of course, be taken of transaction costs. An externality may give rise to a misallocation but the administrative and other costs of correcting it may outweigh the social benefits arising from such action. It is for this reason that many trivial, or relatively trivial, externalities are ignored. However, what may lead to a trivial cost for each individual affected may in aggregate involve non-trivial and even substantial costs. The series of bomb hoaxes which at the time of writing are afflicting the operation of the main London railway termini illustrates the point well. If the time (opportunity) costs of all travellers are delayed and added to (i) their anxiety and hassle costs, (ii) the costs to travellers not directly involved but who in the light of the hoax choose a less preferred mode of transport, and (iii) the costs of security searches, the total must be considerable and would thus justify a substantial outlay in regulating the conduct.

Information deficits and bounded rationality

Consumer choice lies at the heart of the economic notion of allocative efficiency. To aim at a state in which resources move to their more highly valued uses implies that choices between sets of alternatives may be exercised; individuals prefer some commodities to others and such preferences are reflected in demand. The market system of allocation is fuelled by an infinite number of expressions of these preferences. However, the assertion that observed market behaviour in the form of expressed preferences leads to allocative efficiency depends crucially on two fundamental assumptions: that decision-makers have adequate information on the set of alternatives available, including the consequences to them of exercising choice in different ways; and that they are capable of processing that information and of 'rationally' behaving in a way that maximises their expected utility. A significant failure of either assumption may set up a prima facie case for regulatory intervention. Although traditional economic analysis of markets often assumes 'perfect' information, clearly the phenomenon never exists in the real world; some degree of uncertainty as to present or future facts must always be present. Equally clearly, from a public interest perspective, the absence of 'perfect' information cannot itself justify intervention. Given that information is costly to supply and to assimilate, the relevant policy question is rather whether the unregulated market generates 'optimal' information in relation to a particular area of decision-making, that is, where the marginal costs of supplying and processing the level and quality of information in question and approximately equal to the marginal benefits that are engendered. An analogy can usefully be drawn with the way in which an individual makes decisions on acquiring further information by means of comparative shopping. Suppose that I want to trade in the car I currently possess for a new car of a particular model. As I set out, I have no information on the likely price I will pay. The first dealer I visit offers me the new car for a certain sum . . . plus my car. Should I proceed to other dealers to obtain comparable information? Rationally, I should do so only if the benefit, the chance of obtaining a better price . . . exceeds my marginal cost . . . in terms of time and travel etc. in visiting the second dealer . . . . Indeed, I should go on obtaining further price quotations up to the point where the marginal cost of obtaining the last quotation equals the marginal benefit — I shall then have obtained the 'optimal' information for the transaction . . . [For a number of] reasons, precise estimation of 'optimal' information are unattainable, nevertheless it is possible to identify situations in which the information generated by the unregulated market is likely to be substantially sub-optional, thus locating areas of 'information failure' for possible interventionist measures.

The costs to consumers of acquiring adequate information on which to make purchasing decisions are often substantial. By means of advertising, sellers can typically provide this information more cheaply because economies of scale are involved and, in a competitive market, they have an incentive to do this, in order to distinguish their products from those of their competitors. There are, however, several factors which may blunt this incentive, or else lead to countervailing inefficiencies. First, the fact that information typically has a public good dimension — it

https://doi.org/10.1017/CBO9780511801112.003 Published online by Cambridge University Press

is difficult at low cost to restrict its transmission to those who directly or indirectly pay for it and consumption by one user does not lower its value to other users – implies that there will be an under provision of such information in the unregulated market. Secondly, a seller's effort to distinguish his products from those of his competitors may lead to artificial product differentiation. This is a process in which potential buyers are led to believe that a particular commodity has special characteristics which either do not exist or are insignificant in relation to its use of consumption. The consequence is that the seller obtains a degree of monopolistic power over the product which is economically undesirable. Thirdly, the seller's incentive may extend to supplying false or misleading information, as well as accurate information, if he believes that that will enhance his profits. Such a practice may, of course, give rise to private law remedies for misrepresentation, and the prospect of a contract being held unenforceable, or damages being ordered, will reduce the incentive to cheat. For this purpose, it is important to appreciate that not all purchasers need to sue, or threaten to sue, for the private law sanction to be effective. The existence of a sufficient number of individuals at the margin – estimated to be about one-third of all customers – able to detect the deception and threaten effective action will ensure that competitive pressures are sufficient to discipline traders. Nevertheless, there may not be a sufficient number at the margin able to detect the deception, and for those who do the transaction costs incurred in taking steps to complain and threaten legal action may be high relative to their individual losses. To meet such contingencies, regulatory controls may be prima facie justifiable. Fourthly, competition may induce sellers to provide information as to a product's positive qualities, but what about negative qualities, that is, potential defects and risks? For obvious reasons, they are unlikely to be alluded to in advertising materials.

Another problem arises from the fact that information as to quality is more costly to supply and process then information as to price. Prices are calculated by reference to objective criteria (currency) and, in general, are easily communicated. Qualities are to some degree subjective and, particularly in the case of professional services and technologically more complex commodities, may not be discoverable by pre-purchase inspection. It follows that although consumers rationally trade price off against quality – they will be prepared to pay more for superior quality – if, on the information readily available to them, they can discriminate between prices but not between qualities, traders with higher-quality products will be driven out of the market, and there will be a general lowering of standards.

The assumption that individuals are capable of processing the information available to them and of making 'rational' utility-maximizing choices on the basis of it may be essential to the operation of the market model, but exploration of it lies largely outside the parameters of economic analysis. Most economists accept the notion that human behaviour is constrained by 'bounded rationality', that is, that the capacity of individuals to receive, store, and process information is limited. There has been some attempt to erect a model of decision-making based not on finding a utility-maximizing solution but rather on 'satisficing' that is, searching

> until the most satisfactory solution is found from among the limited perceived alternatives. But work of this kind has mainly been the province of psychologists, and mainstream economists have not refined their models of human behaviour to accommodate the problem.

The view of regulation portrayed in the preceding extract is essentially instrumental. Regulation is cast as a social practice that does or should function as a means to an end: that of maximising general welfare, conceived in terms of maximising allocative efficiency. Regulation may do this by correcting market failures, enhancing the efficiency of market-based ways of deciding what shall be produced, directing how resources shall be allocated in the production process and to whom the various products will be distributed. The instrumental nature of regulation from this perspective is linked to the facilitative role that law plays within regulation. Public interest theories of regulation tend to assume that regulation is embedded within legal rules enacted by legislatures, who may then delegate detailed rule creation to regulatory officials along with sometimes considerable discretion in developing such detailed rules. The legal rules in this picture are an instrument for shaping social behaviour, which regulatory officials will typically choose by evaluating whether using law in this way 'works'; i.e. whether it has the effect of securing the desired result, such as a correction of the identified market failure. Although this view of law's role may seem uncontroversial to non-lawyers, it differs considerably from the approach taken by legal academics concerned with analysing legal doctrine expounded by judges, who often focus on the internal coherence of judicial reasoning rather than on social outcomes. Public interest theories of the welfare economic kind adopt an instrumentalist view of the law, regarding it, as Tony Prosser puts it in a subsequent extract, 'as a tool used by state bodies to achieve their ends through the design of institutions'.

2.2.2 Substantive political approaches

Emphasis on the law's facilitative role in regulation may point to a possible limitation of economic conceptions of regulation, which do not explicitly incorporate values other than those concerned with achieving allocative efficiency. The underlying conception of the public interest underpinning welfare economic versions of theories of regulation is relatively narrow. They assume no more than that greater allocative efficiency in the use of society's scarce resources will reduce economic waste and allow more individuals to pursue whatever they personally consider to be their own version of the good life, expressed in terms of their ability to pay. In other words, the collective welfare is defined exclusively in terms of efficient resource use. By contrast, 'political versions' of public interest theory are more ambitious, in two important ways. Firstly, values such as social justice, redistribution or paternalism may also figure in the critical assessment of what justifies regulation. Secondly, they place greater emphasis on the *intrinsic* value

of participation through a process of dialogue. From this perspective, regulation is justified when it establishes institutions that can foster collective learning through a process of participatory dialogue. Political versions of public interest theories of regulation therefore adopt a more multi-faceted conception of the public interest than economic theories; one arrived at by deliberation, mutual interchange, dialogue and collective processes.

The following two extracts illustrate these points. In the first, Sunstein discusses a range of non-economic substantive goals that justify regulatory intervention: public-interested redistribution, reducing social subordination, promoting diversity of experience, preventing harm to future generations, embodying collective desires and shaping endogenous preferences.

Cass Sunstein, '*After the rights revolution: Reconceiving the regulatory state*' (1990)

[Powerful] claims can be made, in principle, for social and economic regulation. In this respect, the relatively well-understood phenomenon of "market failure" is supplemented by a range of other defects in market ordering. A general regime of deliberate preference-shaping through governmental control of desires and beliefs is of course a central characteristic of totalitarian regimes. No one should deny that such a regime would be intolerable. But it would be most peculiar to take that point as a reason to deprive citizens in an electoral democracy of the power to implement collective aspirations through law, or to counteract, by providing information and opportunities, preferences and beliefs that have adapted to an unjust or otherwise objectionable status quo. [In fleshing out such goals], regulatory statutes . . . fall into recognizable patterns; they are often subject, at least in principle, to a powerful defence. [Such defences include redistribution, collective desires, diverse experiences, social subordination, endogenous preferences and the interests of future generations or nature].

Public-interested redistribution

Many statutes are designed to redistribute resources from one group to another. Some respond to a widely held or easily defended view that the benefited groups have a legitimate claim to the relevant resources. Statutes directly transferring resources to the poor or the disadvantaged . . . all fall in[to] this basic category.

Often redistributive measures do not directly transfer resources to disadvantaged people or to those whom we wish to subsidise, but instead attempt to deal with coordination or collective action problems faced by large groups. As we have seen, statutory protection of workers can be understood as efforts to overcome the difficulties of organization of many people in the employment market. Suppose, for example, that numerous employees prefer a nine-hour to a twelve-hour day. Suppose as well that many or most or all of them would prefer working twelve hours to not working at all. Workers may not be able to rely on the labor market to achieve their favored alternative. Individual workers will compete against each other to their collective harm. If their preferred solution is to be provided, it must be as a result of statutes that eliminate the option of unlimited working hours.

Because of the collective action problem, regulatory statutes must make the relevant rights inalienable. If workers are left free to trade these rights, the collective action problem will rematerialise. Labor markets create a prisoner's dilemma that is soluble only through governmental action. Ideas of this sort help justify minimum wage and maximum hour legislation and indeed [fair labour legislation] ... in general — though the distributional consequences here are complex, and there are many losers as well as winners, even within the group of workers. This kind of collective action problem produces a rationale for regulation that is based on redistribution rather than on economic efficiency. It is not at all clear that it is efficient to allow the creation of cartels among workers, even if it is in the interest of those thus authorised; and this latter point is not entirely clear in light of the fact that (for example) the minimum wage increases unemployment.

Regulation is often an attempt to redistribute resources to certain groups. Health and safety regulation is sometimes justified as a means of transferring resources to workers and consumers at the expense of employers and producers, whether or not there is a collective action problem. But redistributive rationales for regulation are heavily contested, and for good reason. In general, regulatory strategies are inferior to direct transfer payments as a means of redistributing wealth. One of the paradoxes of the regulatory state is that efforts to redistribute resources through regulation tend to hurt the least well-off, and in any case to have complex effects, many of them unintended and perverse. The market is extremely creative in overcoming efforts to transfer resources through regulation.

Consider, as particular examples, minimum price supports for farmers and rent control. It is by no means clear either that these regulations benefit a class with a strong claim to the public purse, or that the intended redistribution will really occur. Rent control, for example, has not served as a direct transfer of resources to the disadvantaged. On the contrary, it has discouraged new investment in housing, decreased the available housing stock, and benefited existing tenants, many of them financially well-off, at the expense of others, many of them poor.

There is a general lesson here. People often think that regulation produces a simple redistribution from one class to another, but the distributive effects of regulation are complex and sometimes unfortunate, in light of the flexibility of the market in ensuring ex ante adjustments to regulatory controls. Thus, for example, minimum wage legislation reduces employment, and some occupational health legislation decreases both salaries and employment. (To say this is not to say that such legislation should be repealed; it is necessary to know the magnitude of all of these effects in order to make such a judgment.) A related problem is that regulation sometimes benefits groups that might not deserve the help; it is not easy to argue that farmers as a class should receive the massive and varied subsidies embodied in federal law.

Collective desires and aspirations

Some statutes should be understood as an embodiment not of privately held preferences, but of what might be described as collective desires, including aspirations, "preferences about preferences", or considered judgments on the part of significant

segments of society. Laws of this sort are a product of deliberative processes on the part of citizens and representatives. They cannot be understood as an attempt to aggregate or trade off private preferences. This understanding of politics recalls Madison's belief in deliberative democracy.

Frequently, political choices cannot easily be understood as a process of aggregating prepolitical desires. Some people may, for example, want nonentertainment broadcasting on television, even though their own consumption patterns favor situation comedies; they may seek stringent environmental laws even though they do not use the public parks; they may approve of laws calling for social security and welfare even though they do not save or give to the poor; they may support antidiscrimination laws even though their own behavior is hardly race- or gender-neutral. The choices people make as political participants are different from those they make as consumers. Democracy thus calls for an intrusion on markets. The widespread disjunction between political and consumption choices presents something of a puzzle. Indeed, it sometimes leads to the view that market ordering is undemocratic and that choices made through the political process are a preferable basis for social ordering.

A generalization of this sort would be far too broad in light of the multiple breakdowns of the political process and the advantages of market ordering in many arenas. But it would also be a mistake to suggest, as some do, that markets always reflect individual choice more reliably than politics, or that political choices differ from consumption outcomes only because of confusion, as voters fail to realise that they must ultimately bear the costs of the programmes they favor. Undoubtedly consumer behavior is sometimes a better or more realistic reflection of actual preferences than is political behavior. But since preferences depend on context, the very notion of a ''better reflection'' of ''actual'' preferences is a confused one. Moreover, the difference might be explained by the fact that political behavior reflects a variety of influences that are distinctive to the context of politics. These include four closely related phenomena. First, citizens may seek to fulfil individual and collective aspirations in political behavior, not in private consumption. As citizens, people may seek the aid of the law to bring about a social state in some sense higher than what emerges from market ordering. Second, people may, in their capacity as political actors, attempt to satisfy altruistic or other-regarding desires, which diverge from the self-interested preferences characteristic of markets. Third, political decisions might vindicate what might be called meta-preferences or second-order preferences. A law protecting environmental diversity and opposing consumption behavior is an example. People have wishes about their wishes: and sometimes they try to vindicate those second-order wishes, or considered judgments about what is best, through law. Fourth, people may precommit themselves, with regulation, to a course of action that they consider to be in the general interest; the story of Ulysses and the Sirens is the model here. The adoption of a Constitution is itself an example of a precommitment strategy.

For all these reasons people seem to favor regulation designed to secure high-quality broadcasting even though their consumption patterns favor situation

comedies – a phenomenon that helps justify certain controversial regulatory decisions by the Federal Communications Commission requiring nonentertainment broadcasting and presentations on issues of public importance. The same category of aspirations or public spiritedness includes measures designed to protect endangered species and natural preserves in the face of individual behavior that reflects little solicitude for them.

The collective character of politics, permitting a response to collective action problems, helps to explain these phenomena. People may not want to satisfy their meta-preferences, or to be altruistic, unless they are sure that others will be bound as well. More simply, people may prefer not to contribute to a collective benefit if donations are made individually, but their most favored system might be one in which they contribute if (but only if) there is assurance that others will do so. The collective character of politics might also overcome the problem, discussed below, of preferences and beliefs that have adapted to an unjust status quo or to limits in available opportunities. Without the possibility of collective action, the status quo may seem intractable, and private behavior will adapt accordingly. But if people can act in concert, preferences might take a quite different form; consider social movements involving the environment, labor, and race and sex discrimination. In addition, social and cultural norms might incline people to express aspirational or altruistic goals in political behavior but not in markets. Such norms may press people, in their capacity as citizens, distinctly in the direction of a concern for others or for the public interest. The deliberative aspects of politics, bringing additional information and perspectives to bear, may also bring out or affect preferences as expressed through governmental processes.

Government action is a necessary response here. Possible examples include recycling programmes, energy conservation programmes, and contributions to the arts, to the poor, and to environmental protection. The collective action problem interacts with aspirations, altruistic desires, second-order preferences, and precommitment strategies; all of these are most likely to be enacted into law in the face of a question of collective action. Moreover, consumption decisions are a product of the criterion of private willingness to pay, which contains distortions of its own. Willingness to pay is a function of ability to pay, and it is an extremely crude proxy for utility. Political behavior removes this distortion (which is not to say that it does not introduce distortions of its own).

These general considerations suggest that statutes are sometimes a response to a considered judgment on the part of the electorate that the choices reflected in consumption patterns ought to be overcome. A related but more narrow justification is that statutes safeguard noncommodity values that an unregulated market protects inadequately. Social ordering through markets may have long-term, world-transforming effects that reflect a kind of collective myopia in the form of an emphasis on short-term considerations at the expense of the future. Here regulation is a natural response. Examples include promoting high-quality programming in broadcasting, supporting the arts, and ensuring diversity through protection of the environment and of endangered species. In all of these respects, political choices are not

made by consulting given or private desires, but instead reflect a deliberative process designed to shape and reflect values . . . .

. . . The argument for regulation embodying collective desires is much weaker in three categories of cases. First, if the particular choice foreclosed has some special character – for instance, some forms of intimate sexual activity – it is appropriately considered a right, and the majority has not authority to intervene. Second, some collective desires might be objectionable or distorted. A social preference against racial intermarriage could not plausibly be justified as reflecting an aspiration or a precommitment strategy – though to explain why, it is necessary to offer an independent argument, challenging that preference and invoking a claim of justice. Third, some collective desires might reflect a special weakness on the part of the majority; consider a curfew law, or perhaps prohibition. In such circumstances, a legal remedy might remove desirable incentive for private self-control, have unintended side-effects resulting from "bottling up" desires, and prove unnecessary in light of the existence of alternative remedies. When any of these three concerns arise, the case for protection of collective desires is much less powerful. But in many cases these concerns are absent, and regulatory programmes initiated on these grounds are justified.

Diverse experiences and preference formation

Some regulatory programmes should be understood as an attempt to foster and promote diverse experiences, with a view toward providing broad opportunities for the formation of preferences and beliefs, and for distance from and critical scrutiny of existing desires. This rationale supports private ordering and freedom of contract as well. But it calls for regulatory safeguards when those forces push toward homogeneity and uniformity, as they often do in industrialised nations. For example, the Prevention of Significant Deterioration (PSD) programme of the Clean Air Act protests pristine areas from environmental degradation. The goal is to ensure that in a period of increasing urbanization and homogenisation, federal law ensures the preservation of unspoiled areas. This goal would be a worthy one even if private preferences, as expressed in markets, would not protect such areas. The Endangered Species Act is a similar effort to ensure that current and future generations will be able to explore diverse species of animals and plants.

Regulation of broadcasting – subsidizing public broadcasting, ensuring a range of disparate programming, or calling for high-quality programming largely unavailable in the marketplace – can be understood in similar terms. Indeed, the need to provide diverse opportunities for preference formation suggests reasons to be quite skeptical of unrestricted markets in communication and broadcasting. There is a firm theoretical justification for the much criticised and now largely abandoned "fairness doctrine", which required broadcasters to cover controversial issues and to ensure competing views. The fairness doctrine operated as an exceptionally mild corrective to a broadcasting market in which most viewers see shows that rarely deal with serious problems; are frequently sensationalistic, prurient, dehumanizing, or banal; reflect and perpetuate a bland, watered-down version of the most conventional views

about politics and morality; are influenced excessively by the concerns of advertisers; and are sometimes riddled with violence, sexism, and racism. In view of the inevitable effects of such programming on character, beliefs, and even conduct, it is hardly clear that governmental "inaction" is always appropriate in a constitutional democracy; indeed the contrary seems true.

Social subordination

Some regulatory statutes attempt not simply to redistribute resources, but to eliminate or reduce the social subordination of various social groups. Much of antidiscrimination law is designed as an attack on practices and beliefs that have adverse consequences for members of disadvantaged groups. Discriminatory attitudes and practices result in the social subordination of black, women, the handicapped, and gays and lesbians. Statutes designed to eliminate discrimination attempt to change both practices and attitudes. The motivating idea here is that differences that are irrelevant from the moral point of view ought not to be turned into social disadvantages, and they certainly should not be permitted to do so if the disadvantage is systemic. In all of those cases, social practices turn differences into systemic harms for the relevant group . . . .

. . . It is sometimes suggested that market pressures are sufficient to counteract social subordination, and that statutory intervention is therefore unnecessary. Businesses that discriminate will ultimately face economic pressure from those that do not. The refusal to hire qualified blacks and women will result in competitive injury to discriminators, who will therefore face higher costs and ultimately be driven from the marketplace. This process is said to make markets a good check on discrimination and on caste systems. Although such a process does occur in some settings, market pressures constitute, for several reasons, an inadequate constraint.

First, third parties might impose serious costs on those who agree to deal with members of disadvantaged groups; customers and others sometimes withdraw patronage or services. Consider, for example, the risks sometimes faced by firms that employ blacks, women, the disabled, and gays and lesbians. By their ability to impose costs, customers and others are well situated to prevent elimination of discriminatory practices. In these circumstances market pressures do not check discrimination, but instead guarantee that it will continue. A caste system of some sort is the predictable result. Undoubtedly such pressures have contributed to the perpetuation of discrimination in many settings.

Second, discriminatory behavior is sometimes a response to generalizations or stereotypes that, although quite overbroad and even invidious, provide an economically rational basis for market decisions. Because the behavior is economically rational, not based on a competitively harmful racial animus, it will persist as long as markets do. For example, an employer might act discriminatorily not because he hates or devalues blacks or women, or has a general desire not to associate with them, or is "prejudiced" in the ordinary sense, but because he has found that the stereotypes have sufficient truth to be a basis for employment decisions. Of course

it will be exceptionally difficult to disentangle these various attitudes, and they will frequently overlap; but in light of the history of discrimination against both blacks and women, it would hardly be shocking if stereotyping was sometimes economically rational.

This form of discrimination is objectionable not because it is a reflection of ordinary bigotry or even irrationality, but because it works to perpetuate the second-class citizenship of members of disadvantaged groups. Markets will do nothing about such discrimination; civil rights legislation reduces it. The example suggests that the line between antidiscrimination laws and affirmative action is far thinner than is generally believed.

Third, private preferences of both beneficiaries and victims of discrimination tend to adapt to existing injustice, and to do so in such a way as to make significant change hard to undertake. People often have a "taste" for discrimination, and one of the purposes of antidiscrimination law is to alter that taste. The beneficiaries of the status quo take advantage of strategies that reduce cognitive dissonance, such as blaming the victim. The victims also reduce dissonance by adapting their preferences to the available opportunities or by adapting their aspirations to fit their persistent belief that the world is just. Psychological mechanisms of this sort furnish a formidable barrier to social change.

In a closely related phenomenon, members of disadvantaged groups faced with widespread discrimination on the part of employers may well respond to the relevant signals by deciding to invest less than other people in the acquisition of the skills valued by the market. Individual and group productivity is a function of demand; it is not independent of it. Members of a group that is the object of discrimination may therefore end up less productive, not only because their skin color or gender is devalued, but also because the market sends signals that it is less worthwhile for them to develop the skills necessary to compete.

Fourth, and most fundamentally, markets incorporate the practices and norms of the advantaged group. Conspicuous examples include the multiple ways in which employment settings, requirements and expectations are structured for the able-bodied and for traditional male career patterns. In such cases, markets are the problem, not the solution. One goal of the advocates of antisubordination is to restructure market arrangements so as to put disadvantaged groups on a plane of equality – not by helping them to be "like" members of advantaged groups, but by changing the criteria themselves. A law cannot make it up to someone for being deaf or requiring a wheelchair; but it can aggravate or diminish the social consequences of deafness and lameness. Regulation requiring sign language and wheelchair ramps ensures that a difference is not turned into a systemic disadvantage. Here the conventional test of discrimination law – is the member of the disadvantaged group "similarly situated" to the member of the advantaged group? – itself reflects inequality, since it takes the norms and practices of the advantaged group as the baseline against which to measure inequality.

Statutes protecting the handicapped are the best example here. To say this is not to suggest the nature or degree of appropriate restructuring of the market – a difficult

question in light of the sometimes enormous costs of adaptation to the norms and practices and disadvantaged groups. But it is to say that markets are far from a sufficient protection against social subordination.

Endogenous preferences

Some statutes interfere with market behavior when preferences are a function of, or endogenous to, legal rules, acts of consumption, or existing norms or practices. In these circumstances, the purpose of regulation is to affect the development of certain preferences. Regulation of addictive substances, of myopia, and of habits is a familiar example. For an addict, the costs of nonconsumption — of living without the good to which he is addicted — increase dramatically over time, as the benefits of consumption remain constant or fall sharply. The result is that the aggregate costs over time of consumption exceed the aggregate benefits, even if the initial consumption choice provides benefits that exceed costs. Behavior that is rational for each individual consumption choice may ultimately lead people into severely inferior social states. In such cases people would in all likelihood not want to become involved with the article of consumption in the first place. Regulation is a possible response.

Because of the effect of consumption, over time, on certain preferences, someone who is addicted to heroin is much worse off in the long-run — even though the original decision to consume was not irrational if one looks only at immediate costs and benefits. Statutes that regulate addictive substances respond to a social belief that the relevant preferences should not be formed in the first place.

We might describe this situation as involving an intrapersonal collective action problem, in which the costs and benefits of engaging in the relevant activity change dramatically over time for a particular individual. The central point is that consumption patterns induce a significant change in preferences. An addiction is the most obvious case, but it is part of a far broader category. Consider, for example, the sort of myopic behavior, defined as a refusal — because the short-term costs exceed the short-term benefits — to engage in activity having long-term benefits that dwarf long-term costs. Another kind of intrapersonal collective action problem is produced by habits people follow because of the subjectively high short-term costs of changing their behavior even when the long-term benefits exceed the short-term benefits .... For the most part, problems of this sort are best addressed at the individual level or through private associations, which minimise coercion; but social regulation is a possible response. Statutes that subsidise the arts or public broadcasting, or that discourage the formation of some habits and encourage the formation of others, are illustrations. So too are legal requirements to install seatbelts or have people buckle them. The subjective costs of buckling decrease over time. Once people are in the habit of buckling, the costs become minimal. The fact that the costs shrink rapidly after the habit of buckling has formed counts in favor of regulation, certainly on welfare grounds, and perhaps on autonomy grounds as well.

Moreover, market behavior is sometimes based on an effort to reduce cognitive dissonance by adjusting to current practices and opportunities. The point has large

implications. For example, workers may underestimate the risks of hazardous activity partly in order to reduce the dissonance that would be produced by an understanding of the real dangers of the workplace.

Similar ideas help account for antidiscrimination principles. Most generally, the beliefs of both beneficiaries and victims of existing injustice are affected by dissonance-reducing strategies. The phenomenon of blaming the victim has distinct cognitive and motivational foundations. A central point here is that the strategy of blaming the victim, or assuming that an injury was deserved or inevitable, tends to permit nonvictims or members of advantaged groups to reduce dissonance by assuming that the world is just – a pervasive, insistent, and sometimes irrationally held belief. The reduction of cognitive dissonance is a powerful motivational force, and it operates as a significant obstacle to the recognition of social injustice or irrationality.

Irreversibility, future generations, animals and nature

Some statutes are a response to the problem of irreversibility – the fact that a certain course of conduct, if continued, will lead to an outcome from which current and future generations will be able to recover not at all, or only at very high cost. Since markets reflect the preferences of current consumers, they do not take account of the effect of transactions on future generations. The consequences of reliance on market ordering will sometimes be an irretrievable loss. The protection of endangered species stems in part from this fear. Much of the impetus behind laws protecting natural areas is that environmental degradation is sometimes final or extraordinarily expensive to repair. Protection of cultural relics stems from a similar rationale.

To a large degree, social and economic regulation of this sort is produced by a belief in obligations owed by the present to future generations. Current practices may produce losses that might be acceptable if no one else were affected, but that are intolerable in light of their consequences for those who will follow. Effects on future generations thus amount to a kind of externality. Such externalities might include limitations in the available range of experiences or the elimination of potential sources of medicines and pesticides; consider legislation protecting endangered species.

In more complex forms, arguments of this sort emphasise the multiple values of protecting species, animals, and nature. Some of these arguments are ''anthrocentric'', in the sense that they focus on the ultimate value of such protection to human beings. For example, many people enjoy seeing diversity in nature; and plants and animals furnish most of the raw materials for medicines, pesticides, and other substances with considerable instrumental worth to humanity. On this view, the loss or reduction of a species is a serious one for human beings. It is hard to monetise these values because of the difficulty of ascertaining, at any particular time, the many uses to which different species might be put.

A related but somewhat different argument emphasises the value of natural diversity for the transformation of human values and for deliberation about the good. On this view, the preservation of diverse species and of natural beauty serves to alter

existing preferences and provides an occasion for critical scrutiny of current desires and beliefs. Aesthetic experiences play an important role in shaping ideas and desires, and regulation may be necessary to ensure the necessary diversity.

On a different account, the elimination of a species, particular animals, and perhaps of waters and streams is objectionable quite apart from its effects on human beings, and indeed for its own sake. This account itself takes various forms. Sometimes the argument is a democratic one: most people believe that obligations are owed to nonhuman objects, and the majority deserves to rule. Sometimes the invocation of the rights of nonhuman creatures and objects can best be understood as a rhetorical device designed to inculcate social norms that will overcome collective action problems in preserving the environment – problems that are ultimately harmful to human beings. In many hands, however, the argument, sounding in what is sometimes called "deep ecology", does not even refer to human desires. The idea here is that animals, species as such, and perhaps even natural objects warrant respect for their own sake, and quite apart from their interactions with human beings. Sometimes such arguments posit general rights held by living creatures (and natural objects) against human depredations. In especially powerful forms, these arguments are utilitarian in character, stressing the often extreme and unnecessary suffering of animals who are hurt or killed. Animal [welfare legislation] reflects these concerns.

2.2.3 Procedural political approaches

Sunstein's approach to justifying regulatory intervention is based on substantive values other than economic efficiency. His approach rests essentially on civic republican notions of 'virtue'. In other words, it relies on an implicit assumption that political systems define the content of collective agreement on certain ideas about what counts as 'good' in political, social and economic life. The extract from Sunstein above did not include any detail on the philosophical arguments underpinning his suggestions for the political goals and values that he argues justify regulation: we return to this briefly in Chapter 5. But the task of prescribing substantive visions of values that regulation can legitimately pursue is controversial, given the pervasiveness of moral disagreement and value pluralism that characterises modern societies.

Such controversy might be avoided by focusing on deliberative *processes* and attempting to avoid prescribing the substantive political goals or values which regulation should pursue. The extract that follows from Tony Prosser's work articulates this kind of procedural approach. Where a substantive public interest approach might suggest that the reduction of social subordination motivates and justifies (or should motivate) government intervention through law, a deliberative approach would instead ensure that a dialogue takes place between different actors in the regulatory regime about the relative desirability of pursuing such a goal. Prosser stresses, however, that if a dialogue is to approximate true deliberation, it must achieve more than simply bringing different groups together

in a common forum. Rather, the procedures followed in such a dialogue should ideally enable or even encourage participants to reconsider and revise their views and interests as a result of the dialogue, and to so do without undue pressure from unequal power relations between the participants. In other words, there are certain constraints placed on regulatory procedures in this view of regulation, and these constraints, by minimising the effects of power inequalities, give regulation a 'public interest' flavour without specifying the substantive goals that justify regulation.

The following extract is taken from a book in which Prosser links an account of the structure and practice of utility regulation in the UK to certain theoretical aspects of the philosopher Habermas's work. Prosser makes this link by suggesting that a particular concept developed by Habermas, known as the 'ideal speech situation', provides a standard which can be used to criticise the processes provided within a regulatory regime. (The particular subject of his book considers the regulatory regimes established for the telecommunications, gas and electricity industries in the UK.) He emphasises two features of that 'ideal speech situation': firstly, that all participants have the same opportunities to initiate a dialogue, to engage in questioning and to give reasons for their claims and against the claims of others. Secondly, the discussion must be free from the constraints imposed by disparities in power between the participants.

Tony Prosser, '*Nationalised industries and public Control*' (1986)

> My approach [to the role of law in relation to regulated utilities] would seem to reflect an instrumentalist concept of law; that is, seeing public law as a tool used by state bodies to achieve their ends through the design of institutions. In such a model, any assessment of the degree of success achieved could only refer to efficiency in achieving goals at the least possible cost: it would be concerned with the suitability of means rather than with specifying particular goals. However, law also contains a critical element ... Recent criticisms of a purely instrumental concept of law, such as those made by the Critical Legal Studies Movement in the United States, have stressed that law is *not* simply a means of achieving goals directly as it also has an ideological dimension in which the exercise of power is mediated and given justification.
>
> [The essence of my approach is that] law is no longer seen as isolated from politics to form an outside constraint on political life: rather, law is a sub-branch of politics defined by its purpose of legitimation. Secondly, law is a purposive enterprise: rather than being defined as a set of authoritative materials it is a means of achieving social ends. These ends are not arbitrarily decided by the state but have an essential moral element in their definition.
>
> How, then, can this critical element be applied ...? One aspect of the critical approach is ... concerned with ... democratic ideals. Few concepts are in practice more controversial than that of democracy, and in practice it is impossible to draw clear institutional implications from this concept without highly controversial

specification of its content. Specification here will occur through my drawing on the work of one critical theorist, work that has a special relevance to public lawyers – that of Jurgen Habermas. The particular conception of democracy in his work centres around the means of institutionalising a learning process, and Habermas has summarised it as follows:

I can imagine the attempt to arrange a society democratically only as a self-controlled learning process. It is a question of finding arrangements which can ground the presumption that the basic institutions of the society and the basic political decisions would meet with the unforced agreement of all those involved, if they could participate, as free and equal, in discursive will-formation. Democratization cannot mean an a priori preference for a specific type of organization.

A similar stress has also appeared in Freedman's account of arrangements in the United States for the regulation of industry: 'if statements concerning the nature of justice are themselves properly understood as questions inviting a continuing dialogue, then the discussion . . . that follows is an invitation to renewed consideration of means for perfecting the procedural arrangements that prevail for the moment'. Together, these approaches suggest that the central concern will be the development of institutions that can foster the means for learning through a process of participatory dialogue, and that this will be a matter of devising suitable procedures. [As] I argued earlier, . . . the design of institutions is a legal matter: we now have the beginnings of criteria we can draw on in developing legitimate institutions.

I have treated this as a particular conception of democracy. However, why is this the one we should adopt in preference to its many competitors? First, it could be argued that participatory claims are implicit in current arrangements but are not given practical implementation. For example, the very existence of consumer councils for . . . nationalised industries [delivering public utility services such as telecommunications] implies that they are there to provide a means of outside influence on decision-making by the industries and to widen the range of information and viewpoints considered in policy-making. I will compare this with actual practice, however, which to a large extent negatives such claims. Similarly, [as I have argued elsewhere], . . . legal systems in liberal societies ultimately justify themselves by reference to particular ideals which can be compared with existing practices, the disparity [can be] . . . a source of criticism and possible political change. A similar approach could be adopted where it can be established that there are decision-making arrangements justified by appeals to the ideal of participatory decision-making. There is a further sense in which Habermas's work produces criteria against which the legitimacy of institutional design can be assessed, a sense independent of the claims made in a particular society. This is a highly complex argument which I can only summarise in a simplified manner here. In brief, the argument is that certain human interests transcend ideology and so are, in effect, necessary conditions of social existence. One of these is communication; this is necessary in the strong sense that if the norms of rational communication can be established successfully, any attempt to deny them must in fact be an implicit endorsement instead, since even such attempted denial can only be expressed through

communication. Habermas argues that any smoothly functioning communicative interaction rests on an implicit consensus in which various claims are mutually accepted; the claims include the truth of assertions and the correctness of norms referred to in speech. If the consensus breaks down through challenge to the claims, it can only be restored through testing their truth or correctness through discourse, a special form of communication shaped only by the force of the better argument. Thus any act of communication rests on the assumption that the participants will be able to justify the beliefs and norms they uphold through the giving of reasons: an assumption of accountability. In practice this will usually be a fiction because ruling norms and beliefs will be imposed through the exercise of power rather than on rational grounds, but nevertheless communication must proceed as if the assumption were true.

This raises the question of how we could distinguish such 'systematically distorted communication' imposed by force and producing a mere pretence of agreement from a truly discursively justifiable agreement. Habermas resolves this by pointing to the conditions under which a discursively reached agreement could occur: these comprise his central concept of the ideal speech situation. This is characterised in that all participants have the same chances to initiate discourse and to engage in questioning and giving reasons for and against claims made. Thus all assertions and norms are potentially subject to discursive examination. Moreover, as well as there being the opportunity for unlimited discussion, the discussion must be free from the constraints imposed by domination, by disparities in power between the participants. This will ensure that beliefs and norms will only be found to be justified if they are based on generalisable interests rather than being imposed by the powerful. Of course, such a consensus is not achieved in social interaction in practice, but it is presupposed and anticipated in debate, for in justifying belief we have to assume that the outcome of the debate will be shaped by the force of the better argument rather than through the exercise of power as a constraint on discussion. A key point is that the attainment of a justified consensus (truth) can be divorced from the ideal of a particular form of social organisation enabling its attainment.

> Readers impatient of philosophical discussion will be wondering why this [might be] . . . relevant to [discussions] about [regulatory issues such as] public law and nationalised industries. The answer is that the assumed consensus of the ideal speech situation provides a standard against which to assess institutions in terms of the possibility of attaining such consensus through them: it provides, if the argument is valid, an objective base for the critical assessment of institutional legitimacy. Thus the irrationality of domination which today has become a collective peril to life, could be mastered only by the development of a political decision-making process tied to the principle of general discussion free from domination. Our only hope for the rationalization of the power structure lies in conditions that favour political power for thought developing through dialogue. Truth is thus inseparable from the institutional arrangements for its attainment.

In fact, it is possible to translate the criteria of the ideal speech situation directly into concepts familiar to political scientists and, to a lesser extent, to public lawyers.

The first of these is *participation*. However deficient implementation in practice might be, this implies reference to the ideal of the creation of opportunities for widening debate to encompass a range of affected interests and a fuller range of information, and so invokes the ideal of discussion free from domination with equal power to shape the outcome given to all affected. In practice it forms a major legal concern in parts of land-use planning through the public local inquiry and also in the limited areas covered by the principles of natural justice, but has not attracted legal attention elsewhere. In [the context of utility regulation, it is relevant to] . . . the corporate planning process of the nationalised industries, and in . . . the degree to which workers in the industries and bodies acting for consumers have been able to participate in the planning process. . . . .

The second concept is that of *accountability*: in a sense it is the *ex post facto* equivalent of participation. Accountability demands the giving of reasons for actions, and (particularly in relation to the institutions under examination here) the development of procedures and fora through which reasons and explanations for action can be demanded, assessed and lessons learned for the future. Its essence was captured in the Webbs' advocacy of 'measurement and publicity' referring to the establishment of scrutinising machinery based on as free a flow of information as possible . . . .[In the context of utility regulation, it arises in] . . . the arrangements for the accountability of nationalised industries towards consumer bodies, and [in] . . .. Parliamentary accountability through the use of Parliamentary Questions, the work of Select Committees and through audit, together with other forms of scrutiny such as that by the Monopolies and Mergers Commission.

It should be apparent by now that the achievement of any progress towards the criteria of legitimacy is dependent on a relatively free flow of information so that participation can be addressed to a realistic set of choices and so that adequate explanations can be gained for accountability. It is now accepted wisdom that Britain has a highly secretive political culture and the nationalised industries have been no exception to this: concern with the degree of openness [is also central to my argument] . . . .

Legitimacy in practice

The criteria I have set out above have been portrayed as a means of implementing a particular conception of democracy. It should not be thought, however, that they represent some sort of luxury quite independent of the practical effectiveness and efficiency of the institutions being studied; or (even worse) that participation and accountability inherently reduce effectiveness and efficiency, for example through distracting the attention of those who should be getting on with the job in hand. Rather, I [would] argue, that effective planning *implies* participation and accountability, for participation is the only means by which input from the changing environment can reach planners and the only way in which representation can take place of other interests on whom implementation depends. Similarly, it is only through accountability that it is possible to bring different viewpoints to bear on experience and so increase the opportunities for learning from it. This is

particularly so in a political culture of 'elite consensus' with limited opportunity for self-correction ... Thus 'institutional legitimacy is an indispensable condition for institutional effectiveness', as Freedman argues.

It should not be assumed that the criteria I have set out dictate any *particular* institutional or procedural arrangements: they are ideals and their embodiment will be shaped by their context. It would, of course, be wrong to assume that a nationalised industry should be subject to the same procedural constraints as, for example, a central government department. In particular, the fact that some nationalised industries have to operate in competitive markets will have an important effect in shaping the scope for the application of the criteria. The implications of this should not, however, be exaggerated ... the extension of market principles to all economic activity is impossible, both in theoretical and practical terms; and ..., appeals to market legitimation have all too often served simply to disguise lack of accountability for action involving an inevitable political element. [The nub of my argument is] that ... the issue ... is one of how is democracy to be combined with autonomy ... [i.e. one] of the design and interrelation of institutions. It has been argued ... that in complex, differentiated modern societies law is suited not so much to direct intervention to shape social processes as to installing and defining the bounds of autonomous institutions within which learning processes can take place. Law thus provides an 'external constitution' within which processes of social development and interaction with the environment can take place. Market conditions do not do away with the need to create and define institutions, but rather mean that in particular circumstances justifications exist for permitting a considerable degree of autonomy.

2.2.4 The role of law in public interest theories of regulation

The three approaches surveyed above, which we could conveniently label 'welfare economics', 'substantive political' and 'procedural political', respectively, may all be seen as examples of public interest theories of regulation, despite differences between their conceptions of the public interest. While political and welfare economic approaches use very different languages to define the content of the public interest, there is some overlap between the substantive goals advanced by the different theories. This is especially so if one considers 'translating' the public interest goals of the substantive political approach into the language and conceptual framework of the welfare economic approach. For example, the ways in which Sunstein discusses regulation as giving effect to collective desires and aspirations may overlap substantially with the goal of correcting the market failure of information asymmetry that Ogus discusses. Another thread of commonality between the various approaches to public interest theory is the facilitative role that law plays: functioning as an instrument for achieving the chosen public interest objectives. Theories that specify substantive objectives, such as reducing social subordination or improving market efficiency, in many ways treat positive legal commands as an assumed vehicle for the achievement of these objectives. One might almost view them in this sense as theories of the law-making process,

specifying the goals which explain and justify the action of law-makers in formulating legal commands embodied in regulatory regimes that are intended to achieve those substantive goals.

The procedural version of public interest theory offered by Prosser also gives law a facilitative role, albeit with slight differences. In this theory, law (including judicial and regulatory institutions) has the task of devising suitable procedures that will foster participatory dialogue. Law's role here resembles the image of umpire briefly introduced in Chapter 1: establishing and maintaining the boundaries of a space for free and secure interaction between regulatory participants. In so doing, the law is still functioning as a vehicle for achieving the public interest, although what constitutes that public interest will emerge from dialogue between the players. In short, we use Prosser's approach here to illustrate the umpiring facet of law's facilitative role, although it may have additional resonance which we will consider in Chapter 5. As we shall see in the next section, private interest theories of regulation also have strong procedural dimensions, but with rather different implications for the role of law.

2.2.5 Discussion questions

1. Is the relationship between welfare economic approaches to regulation and political public interest approaches complementary, exclusive or interdependent? In particular, can welfare economic approaches take account of values other than economic efficiency by 'translating' or 'reconceiving' them as economic concepts?
2. Might welfare economic approaches be appropriate for some issues, and political approaches for others? — Consider, for example, price regulation in utilities, environmental regulation and public service broadcasting regulation. Identify the harm addressed by regulation, and consider whether it is equally well addressed by welfare economic or political (substantive or procedural) approaches.
3. In thinking about the relationship between political and welfare economic approaches, consider the tension between efficiency and non-efficiency-based goals of regulation, and the extent to which regulation can feasibly serve both. Are there inevitable trade-offs? If trade-offs are inevitable, are they conceptually incommensurable and what implications does this have for how they should be made?
4. Do public interest theories of regulation have any implications for how organisations (such as regulatory agencies, or firms subject to regulation) should order their internal affairs? Consider particularly with respect to the procedural approach outline by Prosser.
5. What difference would it make to consider a regulatory problem such as safety standards for the medical profession if one interprets the public interest justifying regulation on the one hand as a problem of information asymmetry,

or on the other hand as a question of expressing collective desires and aspirations?

6. What are the boundaries of 'public interest' — i.e. when is a group representing a 'public interest' and when is a group representing the interests of its (collective) members? Is the endorsement of group interests by the state a necessary component of a claim to represent the public interest?

2.3 Private interest theories of regulation

Private interest theories of regulation are premised on an assumption that regulation emerges from the actions of individuals or groups motivated to maximise their self-interest. On this view, regulation may or may not promote the public interest, but if it does, it is a coincidence. This is a central aspect of private interest theories, and means that any connection between regulatory intervention and the public interest is a *contingent* one, demonstrable through empirical and context-specific enquiry only. Although this is strictly true of public interest theories as well, it is probably fair to say that public interest theories are often underpinned by an implicit optimism about the capacity of regulation to promote some form of public interest. By contrast, many advocates of a private interest approach to regulation are fairly skeptical about this capacity. Economic versions of private interest theory are especially inclined to challenge public interest justifications offered in support of regulation. Other approaches, especially political ones, hold varying perceptions of the degree to which they consider the public interest to be a meaningful concept at all, or on how likely it is to emerge.

These varying degrees of skepticism can colour the accounts of regulation given by these writers in a manner which may suggest that they are politically opposed to regulation. Any such political judgements are, at least conceptually, neither necessary nor logical aspects of private interest theories. But it is nonetheless true that private interest theories of regulation gained particular prominence in conjunction with the rise of political ideologies in favour of deregulation. Private interest theories have tended to stress the ease with which 'regulatory failure' and 'regulatory capture' occur. Regulatory capture happens when officials within regulatory institutions who are charged with promoting collective welfare develop such close relationships with those they regulate that they promote the narrow interests of this group instead of the public interest of the broader community. It is an important way in which regulatory failure can happen, i.e. when the collective costs of regulation outweigh the benefits it brings.

Thus, there is a kind of mirror-image relationship between the assumptions underpinning public and private interest theories. Public interest theories stress market failure and the capacity of regulation to correct such failures. Private interest theories stress regulatory failure and the tendency of regulation to benefit narrow special interests rather than to promote collective welfare.

2.3.1 Political private interest approaches

Many variants of private interest theory exist, ranging from public choice theory, to principal-agent theory to what is sometimes called 'positive political economy' approaches. We will not delve here into the intricacies of each of these variants, but aim instead to capture some general aspects that are true of all of them. As with public interest approaches, a politically inflected version of the private interest approach can be distinguished from an economically grounded version. The political version might be thought of as a more 'hard-headed' version of the procedural version of political public interest theory represented by Prosser's extract above. The vision here is one of regulation emerging from the cumulative results of various interest groups pressing their views to regulatory agencies and legislators. The emphasis is on regulation emerging from the actual process of this exchange of views, a perspective linked to political science ideas of 'interest group pluralism'.

In political versions of private interest theory, political outcomes, and the regulatory rules in which they are embedded, are the aggregate result of different groups pursuing their own versions of the public interest without any overall umpire imposing constraints on the content of those versions. The 'private' nature of the theory arises because of the absence of any strong sense of a referee: the regulatory arena is shaped, from this perspective, by a political process in which inequality of resources will inevitably give some groups advantages over others. Thus, unlike public interest theories of a political proceduralist kind, there is less emphasis on correcting procedural defects in the regulatory process. Sometimes skewed participation is compensated by a more corporatist process, that is, where the state steps in to legitimate certain groups over others. But even if the state does intervene, interest group pluralism can be contrasted with public interest theories in two ways: it rejects any advocacy of specific substantive goals, and it also rejects the notion that the resulting process is capable of transforming or transcending individual private goals and generating a shared consensus. Instead, the public interest is the aggregate result of the diverse individual and group pressures that have influenced the regulatory process. Private interest theorists are, as stressed, skeptical about the 'thicker' conceptions of collective welfare endorsed by public interest theorists of various stripes. The following extract from Croley captures these features of what he calls 'neo-pluralism', which for our purposes represents a politically inflected version private interest theory of regulation.

Stephen Croley, '*Theories of regulation: Incorporating the administrative process*' (1998)

> The neopluralist takes group interests as central to determining regulatory outcomes. One strand . . . represented by Gary Becker . . . assumes that organised interest groups

https://doi.org/10.1017/CBO9780511801112.003 Published online by Cambridge University Press

compete with one another (using votes and other political resources) to obtain state-provided goods, including favorable regulation. In his model . . . a given group will calculate how many resources it should spend in pursuit of that good, given the value of the political good to its members and the countervailing efforts of other groups. Furthermore, regulatory outcomes are not all-or-nothing propositions . . . but rather reflect the zero-sum equilibrium of countervailing group forces: A "winning" group will gain only up to the point where an opposing group will exert enough resistance to limit the "winner's" gains. The implication of Becker's model is that only the most efficient groups — that is, those that demand political benefits the most as measured by their ability to invest in them — will be able to acquire them, and only insofar as it is worth no other group's cost to resist . . . Another, related strand of the neopluralist theory also takes a benign, though guarded, view of interest-group competition. According to this view too, regulatory outcomes are the result of interest-group pressures, in a regime in which many different groups press their many different interests and concerns upon regulators. Regulators are central to this strand of neopluralist theory, but . . . they function largely as conduits and aggregators for the preferences and demands of private groups.

This is not to say, however, that interest groups always get the regulatory outcomes they want. To the contrary, group success is constrained in two ways. First, groups' abilities to influence regulatory decisions are limited by the costs of mobilizing, communicating their cause to regulators, and providing legislators with electoral resources. Such costs can be considerable. Second, groups face competition from rival groups with incompatible regulatory preferences. Any given group will enjoy the regulatory outcomes it favors only if it can prevail over other groups that favor other outcomes.

Regulators too, then, are constrained by group rivalry. Legislators, for their part, would like to curry the favor of all potential providers of electoral resources. Because not all interest groups want the same policies, legislators will seek to find compromises and to form coalitions among potentially supporting groups whose interests partially overlap. Legislators, in other words, will function as entrepreneurs in putting together prevailing coalitions. Acting in their own interests, they will broker compromises, rewarding the electorally powerful and those whose regulatory goals are compatible with other groups. Consequently, those most able to command electoral resources and those whose interests overlap with other groups' will tend to prevail; those with fewer resources and more unique interests will tend not to prevail. Again, regulatory outcomes in the end reflect a competitive equilibrium among rival groups.

In partial contrast to Becker, however, this more familiar strand of neopluralist theory is ambivalent towards the consequences of interest-group behavior. According to it, interest-group competition can and often does produce lopsided results. But . . . the neopluralist theory is unprepared to conclude that regulatory government inevitably spells domination of the undetecting many by the organised few. The neopluralist theory's main descriptive claim holds instead that interest-group competition is sufficiently pluralistic, especially given the presence of many "public"

interest groups apparently representing broad interests, to undermine the public choice theory's claims and predictions. On this view, regulatory decisionmaking is ... complicated ...: while some interest groups may very well enjoy excessive influence with public decisionmakers ... the problem of illicit interest-group influence is not intractable, but may be solved by adjusting the regulatory decisionmaking apparatus ... For example, ... new methods of statutory interpretation that seek to protect underrepresented interests or that force explicit deliberation and disclosure of statutory goals by legislatures .... [or] reforms facilitating participation in regulatory decisionmaking, including more robust standing rights for interest groups representing underrepresented interests [or] greater reliance on governmental decisionmaking bodies (such as independent agencies ...) who might be less susceptible to uneven interest-group pressures. ... [W]hatever the specific policy reforms advocated, they share a common premise: Such reforms all seek to correct imbalances in the interest-group competition – to level the interest-group playing field. They [have] a favorable view of interest-group competition, so long as that competition is fair. To the extent that many interests are adequately represented by organised groups, the theory endorses group competition. Where, on the other hand, some interests are systematically underrepresented and regulatory outcomes are therefore biased, the theory calls for reforms that in one way or another reproduce the results that would be generated in an environment of healthy interest-group competition.

...

A question arises: [can] the neopluralist theory appeal to actual examples of regulatory policies reflecting a benign compromise among many competing interest groups: Do regulatory outcomes lend strength to the theory's commitment to regulation? Although some questioned the importance of interest-group influence, most scholars studying group politics in the 1960s reached the conclusion that narrow business interests typically prevail in policymaking processes over relatively diffuse public interests. These scholars agreed with the pluralists that interest-group activity is central to explaining policy outcomes, but argued that such activity is characterised much less by competition among heterogeneous interest groups than it is by business-interest domination. This view ... has largely prevailed over the competing view that interest-group influence on policy outcomes is quite modest.

Still, interest group theorists might respond that even if the public interest movement does not defy the public choice theory, it should give one pause about strong versions of that theory. On this view, although the consumer and environmental movements of the early 1970s occurred too late to rescue pluralism, they at least complicate the public choice theory's story. The proliferation of consumer and environmental groups certainly increased interest-group competition in regulatory politics and made regulatory rent-seeking by business groups and trade associations more difficult. But the available empirical evidence does not necessarily provide strong support for even this qualified view. For example...[studies] of interest-group competition following the consumer and environmental movements find

that an increase in the number of interest groups does not automatically translate to greater interest-group competition . . . [W]hile more groups are active in recent years in certain policy domains, there is little interest-group competition on particular policy issues within them. Instead, individual groups tend to create and occupy narrow policy-issue niches in which they face no competition from other groups. By developing policy niches, individual groups enjoy dominance on the specific issues in which they have developed expertise. To be sure, groups may initially compete over the occupation of a policy niche, which provides some support for the neopluralist vision, but the point remains that an increase in the number of interest groups active in regulatory decisionmaking does not necessarily mean more interest-group competition. Taken on its own terms, then, the neopluralist theory of regulation . . . has little to say about such matters as how groups purportedly representing the average voter emerge, whether they are truly representative, and whether their resources are sufficient to allow them to impede rent-seeking by other interest groups. This is not to say that interest group theorists are wrong to believe that on the whole regulatory outcomes do reflect many competing interests. Nor is it to say that their policy reforms aimed at correcting for interest-group imbalances are ultimately misguided. But if the neopluralist theory's commitment to regulation is well placed, it is so for reasons the underdeveloped theory itself has not yet supplied.

2.3.2 Economic private interest approaches

We turn now to the economically grounded version of private interest theories of regulation. This approach is the most skeptical of all of the viability of public interest effects of regulation. This skepticism arises because these theories view the political process itself through the lens of economic theory. This is why some private interest approaches are given the label of 'public choice'; they focus on how individual citizens collectively choose the rules that govern their affairs. Although this conceptualises the provision of regulation itself as if it were a good or service provided at the intersection of forces of supply and demand in the political arena, the word 'public' still recognises the collective and political nature of the outcomes. Economic versions of private interest theory use an analysis of the cost-benefit structure of collective action to conclude that regulation is more likely to reflect the policy preferences of powerful and narrowly focused interest groups and as a consequence to generate net social loss. Croley's summary of public choice theory, the most well-known variant of private interest approaches, nicely summarises the logic underpinning this vision of why regulation emerges.

Stephen Croley, *'Theories of regulation : Incorporating the administrative approach'* (1998)

The public choice theory of regulation analogises regulatory decisionmaking to market decisionmaking. Specifically, it treats legislative, regulatory, and electoral institutions as an economy in which the relevant actors — including ordinary citizens, legislators, agencies, and organised interest groups most affected by regulatory

https://doi.org/10.1017/CBO9780511801112.003 Published online by Cambridge University Press

policies – exchange regulatory "goods," which are "demanded" and "supplied" according to the same basic principles governing the demand and supply of ordinary economic goods. Such regulatory goods include, for example, direct cash subsidies, controls over entry into a market, such as tariffs, controls over the substitutes and complements of economic goods, and price controls. These regulatory goods are demanded by those who stand to gain from them. A producer of a given good, for example, would enjoy great economic benefit from regulations that made substitute goods more expensive and complementary goods cheaper. As the sole supplier of regulation, only the state can supply demanded regulatory goods, which legislators, organised and disciplined by political parties, are willing to do in exchange for the political support they need to stay in office. Regulatory trades take place, then, because they further the (private) economic interests of those on the demand side and the (private) political interests of those on the supply side. The resources necessary to meet suppliers' political needs constitute the "price" of regulatory goods.

Naturally, the outcome of these forces of supply and demand is a function of the constraints under which the participants in the regulatory marketplace operate. These constraints are determined, according to the public choice theory, by the general rules through which democratic political decisions are made. And therein lies the trouble, for democratic decisionmaking results in regulatory policies that benefit narrow interests at the expense of broad interests, for reasons now familiar.

Simply stated, the regulatory interests of the individual voter (or the consumer) are dominated by the regulatory interests of organised subgroups of the citizenry because the latter have incentives to influence regulatory decisionmaking which the former lacks. The individual voter lacks such incentives given the benefit-cost trade-off of pursuing her regulatory interests: The benefits are low; the costs relatively high. In Stigler's words:

What is the consumer's recourse if he is being exploited by a federal marketing order which either neglects his interest or, as is the case at present in the United States, positively arms and protects a cartel in exploiting this consumer? His sole defense is to organise a political campaign to change or eliminate that marketing scheme. For the individual consumer this is a bleak prospect. The costs—in time, effort, and money – to change legislation are large; the reward to any one consumer from joining a consumer lobby is negligible.

As this example suggests, collective action barriers constitute the individual voter's main obstacle to organizing to further her regulatory interests; the individual consumer's "rewards" from her own contribution would be "negligible" . . . [F]or reasons deeply rooted in the logic of collective action, most citizens lack any real incentive to try to influence regulatory outcomes.

Thus, while the public choice theory analogises regulatory behavior to market behavior, it also holds that the analogy ultimately breaks down. From the vantage point of ordinary citizens, the crucial differences between regulatory decisions and market decisions are threefold. First, regulatory decisions are "all-or-nothing" propositions: Whereas in the economic marketplace citizens can decide to patronise

airlines or rail lines, or neither, as their individual needs require, a regulatory decision about whether to provide favorable regulation to either affects all citizens, whether they fly, ride the rails, or neither. The scope of regulatory decisions extends across virtually all citizens, who are affected by those decisions at least on the financing side. And once the state makes a decision about which package of regulatory goods to supply, individual voters have no opportunity to "exit" the regulatory market. Second, regulatory decisions are more permanent than marketplace decisions. Whereas a citizen could elect to fly one week, and then ride a train the next, the collective decision to provide a federal subsidy to the airlines or to the railroads will not be frequently reexamined once made. Finally, regulatory decisions are collective decisions, and, as such, must be made simultaneously. Where some decision depends on whether its supporters outnumber its detractors, those supporters and detractors must, at some discrete point and time, be counted.

Because regulatory decisions are, relative to market decisions, infrequent, simultaneous, and global, regulatory outcomes are undisciplined: Individual citizens have little or no occasion for registering their regulatory interests, including their interests against regulatory policies that bring them no benefits. . . . Direct citizen participation in regulatory decisionmaking is . . . rare — taking place only as often as elections for political representatives — and very crude — citizens vote for political candidates with very little information about those candidates' positions on regulatory issues, and must moreover vote for a mixed bundle of such policies at once. Citizens . . . [therefore delegate] regulatory decisionmaking power to representatives with wide discretion thus creat[ing] significant principal-agent slack, with regrettable consequences. Because most citizens are largely uninformed about most regulatory decisions, and because they moreover lack incentives to become sufficiently informed to reward legislators who do not shirk, legislators do not — cannot — protect the broad regulatory interests of their constituencies. This is true because organised interest groups — industry groups, occupational groups, and trade associations — who are informed because they have an especially high demand for regulatory goods do monitor legislators, punishing those who consistently fail to provide such goods and rewarding those who provide favorable regulation. Thus interest groups capitalise on the opportunities created by principal-agent slack, made worse by most voters' collective action problems, in order to buy regulatory goods that advantage them. For their part, interest groups pursue regulatory goods, like any other goods, up to the point where the marginal costs equal the marginal benefits of doing so. And in contrast to the benefits for the individual voter, the benefits for groups of pursuing favorable regulatory outcomes are often worth the costs. This is true given the concentrated distribution of those benefits. In the context of a federal milk marketing order, the "farmers, milk companies, and laborers in the industry have much larger stakes, and they can and do" undertake the effort necessary to generate marketing orders that favor them. Given that the benefits of regulatory goods are higher for organised groups than for individual voters, the former enjoy much more influence — offer higher bids — in regulatory decisionmaking relative to the latter.

Not that the price of favorable regulation is cheap. . . . Regulation-seeking groups must front the costs of communicating with politicians and participating in political decisionmaking, including the costs of consultants, lawyers, and lobbyists. Second, groups must also cover the costs of earning the support of legislators, which is to say, the costs of providing legislators with political benefits — votes and financial resources. This second cost implies another: Regulation-seeking groups must also pay the costs of "regulatory competition." That is, they must outbid competitor groups, which means that they must not only supply legislators with resources that translate into political benefits, but with more of such resources than competing groups. Thus, no given interest group will enjoy all of the regulatory goods it desires; scarcity constrains any group's buying power.

Even so, the regulatory market works, on the whole, to the advantage of organised groups with narrow interests. Interest groups with the most at stake in a particular regulatory decision, who spend the most to buy that decision, typically see their demand for regulation met by legislators who acquiesce in order to enjoy continued electoral success and the benefits that holding office brings. In the process, ordinary citizens lose, though they rarely feel their loss in any particular case. Nor is the end result purely distributional. The regulatory goods that organised groups obtain often come at a price not worth their costs; concentrated group gains usually "fall short of the [diffuse] damage to the rest of the community." Thus are regulatory policies typically inefficient. As regulatory goods are sold to groups representing concentrated interests, the few gain, and the many lose by more.

The public choice theory's description of regulation carries with it a reform agenda: The view that the fundamental differences between regulatory and market decisionmaking explain the problem with regulation strongly suggests that market outcomes are preferable to regulatory outcomes. And in fact, public choice theorists often argue for increased reliance on markets rather than on government regulation. Limiting regulators' power, and thus their ability to advance the interests of small groups at the greater expense of general interests, would enhance social welfare. Market outcomes, however imperfect, are better than the regulatory products of an intractable regulatory regime.

. . .

A Critical Assessment — The public choice theory constitutes a powerful challenge to those who would preserve the regulatory regime, a challenge which has enjoyed considerable influence. . . . And yet, its case against regulation is by no means entirely compelling.

One problem with the public choice theory concerns the enormous weight it implicitly attaches to legislators' electoral goals. While its premise that legislators supply demanded regulatory goods to groups in exchange for resources that secure their positions in office may be plausible on a general level, the difficulty is that the theory seems to contemplate that legislators are always very worried about the next election — that fear of electoral defeat consistently renders legislators ever willing to meet the highest bidder's regulatory demands. This vision is problematic . . . . Simply

knowing that a legislator seeks security of office does not, without more, imply anything specific about how that legislator will behave or, more particularly, how that legislator will satisfy the regulatory preferences of competing interest groups. [Further] . . . it seems implausible to assume that job security constitutes legislators' only goal – that legislators seek office solely to maintain it.

A second general problem with the public choice theory's conceptual apparatus, and its specific focus on legislator motivation in particular, is . . . that almost all administrators are fairly well insulated from electoral political pressures. Such insulation may give them room to pursue general-interest regulation, subject only to legislative supervision that pulls in the opposite direction . . . .

. . . [P]ublic choice theorists have suggested that their theory is in fact testable; its expectations can be measured against real-world events . . . Unfortunately for the theory, however, the empirical evidence is far from overwhelming. First, specific examples of policies that public choice theorists have offered to provide affirmative support for the theory are fairly rare . . . Public choice theorists have identified regulatory policies in the airlines, securities, telecommunications, television, and trucking industries as their main examples lending credence to the public choice theory's predictions . . . But while these examples may have corroborated the public choice theory at one time, they no longer do so. For regulatory policies in precisely these same areas constitute the examples that the public interest theory invokes on its behalf . . . [P]ublic interest theorists point to deregulation, especially of the airlines, but also of the securities, telecommunications, and trucking industries. At least according to public interest theorists, regulatory policymaking in each of these cases suggests that, at least on important occasions, the concentrated interests of powerful organised groups lose out to the diffuse interests of the mostly unorganised citizenry. Interestingly enough, then, the public choice theory points largely to the same set of facts that other theories identify in support of their (different) predictions. To that extent, these policies are incompatible with the public choice theory's prediction that the average voter/consumer will routinely see her regulatory interests sacrificed to those who are better able to pay the price of favorable regulation. The public choice theory holds that such instances will not occur.

2.3.3 The role of law in private interest theories

In private interest theories as a whole, the role of law has both commonalities with and differences from its role in public interest theories. In terms of commonality, both public and private interest theories tend to assume that law, in the sense of public and democratically enacted rules, is a vehicle for securing collective outcomes. In other words, law continues to play a facilitative role in private interest theories in so far as that role has an instrumental dimension. But unlike public interest theories, private interest theories pose a much more sustained challenge to the idea that these outcomes promote collective *welfare*. This is because they tend to be pessimistic about the possibilities for 'welfare maximising' production of a regulated good. This gives an additional gloss to

https://doi.org/10.1017/CBO9780511801112.003 Published online by Cambridge University Press

assumptions about the role of law, warning that the law is likely to be a means to ends that undermine community welfare. This is a contingent implication that has to be proved empirically in any particular case, as we have already stressed.

A further difference arises from our earlier discussion about how private interest theories conceive of the law as a regulatory good: i.e. the 'product' of a political market, produced at the intersection of the supply and demand of domestic electoral support. That intersection is still an arena of political contestation, but, at least in the national context, law is a monopoly good since the law-making arena is the only place where the good can be produced. This gives law the quality of a passive object that regulatory actors compete for. This is consistent with the idea that once secured, law will act as a vehicle for securing collective outcomes, but the emphasis is on the struggle from which regulatory law emerges. This reflects in part the observation made in Chapter 1 that private interest theories tend to give causal accounts of the emergence of regulatory regimes while public interest theories are more prescriptive, highlighting the regulatory goals that the law should ideally facilitate.

The difference is also linked to diametrically different assumptions about intrinsic human nature underpinning public and private interest theories of regulation. Niskanen, a well-known adherent of a private interest approach to bureaucracy, quotes a British Labour MP in the 1970s in terms which give a vivid flavour to these differences. Countering the suggestion that contracting-out or productivity bonuses might enhance the efficiency of the British civil service, the unnamed politician responds:

> Efficiency in administration lies in service to the people, in understanding, compassion, patience with the weak and ignorant, in being scrupulously fair between one citizen and the other . . . Where do we recruit all these saints? I reply that we already have them in the British Civil Service . . . A good bureaucracy does not need and should not have, the lubricants which make the wheels go round in the world of private enterprise . . . .

That this view now sounds anachronistic need hardly be said, yet few are willing to sacrifice entirely the notion that regulation can harness public-spirited desires to pursue the public interest. It may be that private interest approaches to regulation have provided a necessary corrective to the excessive optimism or even naïveté of public interest theories, pointing to the desirability of a judicious mix of the two, combined with an appreciation of when and why limits to either approach emerge. At least some versions of what could loosely be called institutionalist theories of regulation, which we explore in the next section, seek to achieve just such a mix.

2.3.4 Discussion questions

1. Are economic private interest approaches to regulation complementary to, exclusive of, or interdependent with political private interest approaches? One way of approaching this question is to consider whether economic

https://doi.org/10.1017/CBO9780511801112.003 Published online by Cambridge University Press

approaches are more appropriate for some policy sectors and political approaches for others.
2. What difference would it make to consider a regulatory problem such as safety standards for the medical profession through the lens of regulatory capture on the one hand, the lens of interest group pluralism on the other hand?
3. How does the economic version of private interest theory deal with the problem that some interest groups are more powerful than others?
4. Do private interest theories of regulation have any implications for how organisations (such as regulatory agencies, or companies subject to regulation) should order their internal affairs?
5. In analysing a regulatory regime, is it appropriate to use political public interest approaches to set substantive goals for a regulatory regime and economic private interest approaches for the design of that regime?

2.4 Institutionalist theories of regulation

Our third category of theories of regulation is to some extent a 'grab-bag', grouping otherwise very different theories under one heading for two reasons detailed below. The label 'institutionalist' is intended to capture any theory where rule-based spheres, or the relationship between different rule-based spheres, play an important role in explaining why or how regulation emerges. By 'rule-based spheres' we mean formal organisations (e.g. regulatory agencies, corporations, states), embedded norms and routines (e.g. risk analysis, cost-benefit accounting, precedent, advocacy norms) or 'systems' as understood by system theory (e.g. legal systems, economic systems, political systems). The intent of this section is to present three approaches in sequence, which each give increasing prominence to the role of organisations, institutions and systems in regulatory dynamics. Common to these approaches, which differ from each other in many respects, is that they consider institutional dynamics to have, in a sense, a 'life of their own' in regulatory regimes, such that they will often shape the outcomes of regulation in surprising ways, given the preferences and interests of regulatory participants. A second common factor uniting the approaches grouped under this label is that they increasingly blur the differences between public and private actors, and between public and private interests, differences that have been central to our survey so far.

2.4.1 Tripartism

The first approach, the highly influential one of Ayres and Braithwaite, provides a bridge between the 'actor-centred' approaches discussed so far and more 'systems-focused' approaches that operate at a higher level of abstraction. Ayres and Braithwaite do not take a systems approach, but blend public and private interest approaches in a manner that highlights institutional dynamics. Yet they

retain a very concrete focus on actors, focusing on how an analysis of the costs and benefits that typically accrue to players in the regulation game – redolent of the private interest approach – can, under certain conditions, produce public interest outcomes that are compatible with, and even heightened by, deliberation, dialogue and trust-building empowerment. Ayres and Braithwaite reject the idea that deliberative processes, in the sense used by Prosser in the earlier extract, are incompatible with calculations of cost-benefit payoffs. Instead they argue that the two are compatible, at least *when cooperation pays*. The point at which this occurs is known as the point of 'efficient capture', explained in the following extract.

Ayres and Braithwaite, '*Responsive regulation*' (1992)

In this chapter we argue that features of regulatory encounters that foster the evolution of cooperation also encourage the evolution of capture and corruption. Solutions to the problems of capture and corruption – limiting discretion, multiple-industry rather than single-industry agency jurisdiction, and rotating personnel – inhibit the evolution of cooperation. Tripartism – empowering public interest groups – is advanced as a way to solve this policy dilemma. A game-theoretic analysis of capture and tripartism is juxtaposed against an empowerment theory of republican tripartism. Surprisingly, both formulations lead to the conclusion that some forms of capture are desirable. The strengths from converging the weaknesses of these two formulations show how certain forms of tripartism might prevent harmful capture, identify and encourage efficient capture, enhance the attainment of regulatory goals, and strengthen democracy. Although the case we make for tripartism is purely theoretical and general in its application to all domains of business regulation, our conclusion is a call for praxis to flesh out the contexts in which the theory is true and false.

The problem: Business regulation is often modelled as a game between two players – the regulatory agency and the firm. Naturally the world is more complicated than this. On the state side there are other players like prosecutors and oversight committees of legislators, whereas on the business side there are other players like industry associations. On both sides, individual actors wear many hats. Therefore it is a rash simplification to interpret individual actions as those of the faithful fiduciary of the profitability interests of the firm on the one hand, and the fiduciary of agency interests in securing compliance with its statute, on the other.

This chapter seeks to problematise somewhat this simplification by modelling the idea of capture. Capture is a notion that has enjoyed political appeal among critics of regulation from both the right and the left. Among economists, models of regulatory capture have gained wide acceptance. Yet capture has not seemed to be theoretically or empirically fertile to many sociologists and political scientists working in the regulation literature. Here we will consider whether capture has proved analytically barren for those social scientists because of a failure to disaggregate different forms of capture. Ironically it is an economic analysis that clarifies the disaggregation needed to enable a more fertile social analysis of capture.

The Evolution of cooperation, corruption, and capture: Although the simplifications involved in modelling regulation as a game between two players with unproblematic interests are transparent, such simple models, with their elegance and clarity, can be the foundations on which we build more subtle and complex accounts. Moreover, simple prisoner's dilemma models of regulation do have some capacity to explain regularities in regulatory outcomes. These are models that construe regulation as a game between two players, each of which can choose between cooperating or defecting from cooperation with the other player. For the firm, defection means law evasion; for the regulator, defection means punitive enforcement. Whatever the other player does, defection results in a higher payoff than cooperation. The dilemma is that if both defect, both do worse that their joint cooperation payoff.

Let us illustrate this explanatory capability and in doing so go to the nub of the theoretical concern of this chapter. Grabosky and Braithwaite's (1986) study of ninety-six Australian business regulatory agencies found that agencies were more likely to have a cooperative (nonprosecutorial) regulatory practice when they regulated: (1) smaller numbers of client companies; (2) a single industry rather than diverse industries; (3) where the same inspectors were in regular contact with the same client companies; and (4) where the proportion of inspectors with a background in the regulated industry was high.

Grabosky and Braithwaite interpreted these findings as support for [the] notion of . . . formal law increasing as relational distance between regulator and regulatee increases, and more ambiguously as support for capture theory. But equally these findings are just what would be predicted from . . . theor[ies about cooperation] . . . [that] . . . show that the evolution of cooperation should occur only when regulator and firm are in a *multiperiod* prisoner's dilemma game. Repeated encounters are required for cooperation to evolve . . . Thus, cooperation should be more likely when the same inspector is repeatedly dealing with the same firm. Similarly, when an agency regulates a small number of firms in a single industry the chances of repeated regular encounters are greater than with an agency that regulates all firms in the economy. And indeed inspectorates recruited from the industry may be in a better position to secure an evolution of cooperation because they are enmeshed in professional networks that give more of an ongoing quality to their relationship.

Yet the fact that such findings can be interpreted in either capture or evolution of cooperation terms goes to the heart of our dilemma. The very conditions that foster the evolution of cooperation are also the conditions that promote the evolution of capture and indeed corruption. A revolving door simultaneously improves the prospects of productive cooperation and counterproductive capture. Where relationships are ongoing, where encounters are regularly repeated with the same regulator, corruption is more rewarding for both parties: the regulator can collect recurring bribe payments and the firm can benefit from repeated purchases of lower standards. Moreover, ongoing relationships permit the slow sounding out of the corruptibility and trustworthiness of the other to stand by corrupt bargains (and at minimum risk because an identical small number of players are involved each time).

This is why if you are looking for corruption in a police force, you look at those areas where there is regular contact between police in a particular squad and long-term repeat lawbreakers — prostitution, illegal gambling, other vice squad targets, and organised drug trafficking. You are less likely to find it in police dealings with robbers, burglars, and murderers. The ninety-six-agency Australian regulation study found (via highly speculative data) that corruption was more likely in agencies that had two qualities: they maintained close cooperative relationships with the industry, and engaged in regular sanctioning of the industry. Cooperation corrupts; cooperation qualified by the possibility of defection corrupts absolutely!

Classically, enforcement agencies deal with the risks of corruption and capture by regular rotation of personnel. Contrary to the policy prescription required for the evolution of cooperation, the anticorruption policy is to ensure that the suspect confronts different law enforcers on each contact. Officers are rotated between regions and among sites within regions.

Another variant of the same policy dilemma arises with discretion. Wide discretion "presents a real danger of corruption and capture". But narrow discretion results in rulebook-oriented regulation that thwarts the search for the most efficient solutions to problems like pollution control. When the reward payoff for cooperation is low as a result of such confining discretion, then the evolution of cooperation is unlikely. Might it be possible, however, to allow discretion to be wide, but to replace narrow rule-writing to control capture with control by innovative accountability for the exercise of wide discretion?

This then is the policy nut we seek to crack. How do we secure the advantages of the evolution of cooperation while averting the evolution of capture and corruption? Our answer lies in a republican form of tripartism. Tripartism is a process in which relevant public interest groups (PIGs) become the fully fledged third player in the game. As a third player in the game, the PIG can directly punish the firm. PIGs can also do much to prevent capture and corruption by enforcing . . . a norm of punishing regulators who fail to punish noncompliance. Here the effect of the PIG on the firm is mediated by the PIG's effect on the regulator — instead of directly punishing firms, it punishes regulators who fail to punish firms. [This]. . . can dramatically increase the prospects of stable compliance. The fully fledged tripartism we consider, where PIGs are empowered to punish firms directly, is a more radical option that has been conspicuously unanalysed, in spite of incipient instances of its implementation in many countries.

Who guards the guardians? In another sense this chapter is about who guards the guardians. The problem of guardianship . . . is that we tend to deal with failures of trust by accumulating more and more layers of guardianship. The untrustworthiness of nth order guardians is monitored by $n+1$th order guardians, and so on in infinite regress. In the present case, who will guard the PIGs? PIGs can be captured and corrupted; history is littered with cases of PIGs caught with their snouts in the trough.

We hope to show that this way of setting up the problem entails a rather too mechanistic conception of guardianship. What we put in its place is a notion of

contestable guardianship. The idea of contestable markets arises where there is such a small number of producers in a market as to provide little direct guarantee that they will vigorously compete to hold each other's prices down. According to the theory, firms will nevertheless hold prices down because, as long as there are not formidable barriers to entry, they will fear that high prices will cause the entry of a new competitor who will seize their market share with lower prices.

The trick of institutional design to deal with the problem of regulatory capture, we suggest, is to make guardianship contestable. This is no easy matter, just as it is no easy matter to render economic markets contestable. Of course, the fact that economic markets rarely fit the theory of contestability says nothing about the possibilities for rendering political influence contestable in a democracy. To secure contestability, what is required is a regulatory culture where information on regulatory deals is freely available to all individual members of a multitude of PIGs. Also required is a vital democracy where PIG politicians are always vulnerable to accusations of capture by competing PIG political aspirants who stand ready to replace them. If talk of competition for PIG influence seems unreal, it is only because we are thinking of arenas where PIGS are powerless; where PIGs are empowered, aspirants emerge to contest the incumbency of PIG politicians.

Contestability can mean more than simply competition within the PIG sector for seats at the bargaining table. It can also mean, in a manner more directly analogous to contestable markets, pro-consumer discipline exercised by the potential of PIG entry into a regulatory domain that PIGS have decided not to enter. In a regulatory culture characterised by consumer groups becoming politically active whenever major consumer interests are threatened, the mainstream players of the regulatory game may guard against such consumerist assault by being mindful of consumer interests.

What Is Tripartism? Tripatism is defined as a regulatory policy that fosters the participation of PIGs in the regulatory process in three ways. First, it grants the PIG and all its members access to all the information that is available to the regulator. Second, it gives the PIG a seat at the negotiating table with the firm and the agency when deals are done. Third, the policy grants the PIG the same standing to sue or prosecute under the regulatory statute as the regulator. Tripartism means both unlocking to PIGs the smoke-filled rooms where the real business of regulation is transacted and allowing the PIG to operate as a private attorney general.

Generally in this book we refer to the simplest model of tripartism where a single PIG is selected by the state (or by a peak council of PIGs) as the most appropriate PIG to counterbalance the regulated actors. That PIG then elects its representative to participate in that regulatory negotiation. Contestability in this simple model is, therefore, accomplished by (1) different PIGs competing for the privilege of acting as the third player in the regulatory negotiation; and (2) different PIG politicians within each PIG competing for election to the negotiating role. The simplest model will not always be the most appropriate – the appropriate model of tripartism will be an historically and institutionally contingent matter. However, the simplest model has definite attractions: it should delay minimally decision making in arenas where

no decision is the worst possible decision. And it should maximise the prospects of genuine dialogue around the table leading to a discovery of win-win solutions, instead of a babble of many conflicting voices talking past each other. In this book, tripartism is considered as a strategy for implementing laws and regulations that have already been settled. If one wanted to extend its application to the rule-making process itself, an extension that may have merit, then clearly the simple tripartism model would provide too narrow a basis for PIG participation.

But who are the PIGs? Here it is best to resist pleas for a clear definition of the public interest and who represents it. One reason is that what we ultimately favour is a contested, democratic theory of the public interest rather than an account that can be neatly packaged in advance of the operation of democratic process. Second, what we urge democratic polities to do is identify, on an arena-by-arena basis, the group best able to contest (rather than "represent") that public interest embodied in a particular regulatory statute. These groups are thrust into the breach to fight for the public interest the legislature intended to be protected by a regulatory statute; but, in fact, they will more often than not be private interest groups.

An environmental group empowered as the third party in environmental regulation may be a PIG largely devoid of private interest. But we include as PIGs trade unions empowered to defend the interests of their members in occupational health and safety regulation. Indeed, it could even be that a suitable group to contest the public interest in a consumer protection statute to guarantee the quality of automobiles could be the industry association of car rental firms. The most knowledgeable group to intervene in a cozy regulatory arrangement that maintains oligopolistic prices for wheat may be the industry association of flour millers.

. . . The simplest arena to understand how tripartite regulation would work is with occupational health and safety. In a unionised workplace, elected union health and safety representatives would have the same rights to accompany the inspector in the workplace as the company safety officer. They would have the right to sit in on and ask questions at any exit conference at the end of the inspection and at any subsequent conference. They would receive copies of the inspection report and of any subsequent correspondence between the parties. If they perceived an unwarranted failure to prosecute, to shut down a machine or to take any other enforcement action, they would have the same standing as the government inspector to pursue that enforcement action . . .

As Meidinger (1987) cogently argues, there is no touchstone, no objective standard, by which we can separate the public interest from private interests. Social life seems "almost always to involve a combination of pecuniary interest-pursuit and citizenship" In practical terms, citizen concerns about themselves motivate their identification of public concerns: "reason is mostly likely to be applied by passion — in the form of interests". This is not to support the crude "deals thesis" that one sometimes sees in law-and-economics writing. Regulation is largely contested in a public-regarding discourse; it is a shallow analysis to view interest groups as unashamedly using the state regulatory apparatus as no more than a vehicle for advancing their private interests. Certainly, our conclusion will be that

> this latter form of discourse should be discouraged by our regulatory institutions. Public-regarding discourse, which is already encouraged in many ways by regulatory agencies and the courts, should be further encouraged ... Achieving regulatory effectiveness through a balance of control is not about simply striking a compromise of interests. It is about understanding each other's needs and then sharing ideas in the pursuit of risk management strategies that deliver acceptable protection at acceptable cost. As the negotiation experts have instructed us, we will all do better if we focus less on positions and more on designing new solutions that are responsive to mutually understood needs, new solutions that may bear no relation to initial bargaining position ...

As the last paragraph of the above extract shows, the approach of Ayres and Braithwaite explicitly aims to blend both public and private interest assumptions about human nature. They do so by arguing that a particular institutional design — tripartism — can create a system of checks and balances that harness private interests to work in favour of the public interest. Although they caution that their strategy applies more clearly to the implementation of existing regulatory regimes, their approach has been so influential in regulation scholarship as a whole that it is presented here as one that could apply to explaining the emergence of a regulatory regime. The discussion questions encourage further reflection on whether this extension of the original scope of their theory is workable.

2.4.2 Regulatory space

Our second example of an institutionalist approach is known as a 'regulatory space' approach and moves further away from delineating 'public' and 'private' interests and casting them in opposition to, or tension with, each other. Instead, the idea of regulatory space emphasises a place where regulation occurs, almost a kind of physical arena which influences the practices that happen within it. In so doing, less emphasis is placed on individuals and groups and the outcomes they pursue or aspire to. Indeed, Hancher and Moran in the next extract go so far as to say that 'little can be gained by depicting [regulation] in the dichotomous language of public authority versus private interests'. Instead, a regulatory space approach examines how the actions and intentions of regulatory actors are embedded in larger systems and institutional dynamics. For example, utilities regulation may involve very similar actors in different countries and yet different national political contexts would shape the preferences of these actors in different ways, leading to the emergence of different regulatory regimes. The extract from Hancher and Moran includes some discussion of how such different national political contexts shape regulation, a discussion that is taken up again in Chapter 4 in relation to how different national contexts shape regulatory enforcement. More generally, they emphasise 'system dynamics' over the specific preferences and interests of individual groups or actors. 'Regulatory space' contains

not only state actors and formal public authority, but also non-state actors and sources of authority over which the state may not have a monopoly such as information, wealth and organisational capacity. Two important ideas emerge from this approach. The first is the limited relevance of law and formal public authority within a regulatory space. The second is that regulatory outcomes might not align with the predictions of private interest theory, because history, national culture and organisational dynamics (such as the standard operating procedures of large institutions) may shape the regulatory dynamics of a particular policy sector in ways that the combined interests of the different actors would not.

Hancher and Moran, '*Organizing regulatory space*' (1989)

> Regulation is virtually a defining feature of any system of social organization, for we recognise the existence of a social order by the presence of rules, and by the attempt to enforce those rules. . . . Within the broad field of regulation, however, a special place is occupied by . . . the regulation of economic activity in Western capitalist societies, where organization on market principles is combined with a high level of industrial development. Economic regulation under advanced capitalism has several distinctive features, and these features in turn shape the character of regulatory activity . . . The most striking single feature of economic regulation is that it is dominated by relations between large, sophisticated, and administratively complex organizations performing wide-ranging economic and social tasks. Such bodies obviously include the various agencies of the state – government departments, quangos, and specialised regulatory bodies – but they also encompass organised interest groups, trade unions, and firms. The importance of the large firm in the regulatory process is particularly notable. Indeed an important theme is the central place of the large, often multinationally organised, enterprise as a locus of power, a reservoir of expertise, a bearer of economic change, and an agent of enforcement in the implementation process. Understanding economic regulation, then, means understanding a process of intermediation and bargaining between large and powerful organizations spanning what are conventionally termed the public and private domains of decision-making. But this understanding points to an important, related, feature. The economies of advanced capitalist societies have been universally marked by a high level of state intervention. Regulation is embedded in the practices of the interventionist state. The aims of regulation are commonly only explicable by reference to the wider structures and more general aims of the interventionist system. Economic regulation under advanced capitalism – its formation as much as its implementation – invariably involves interdependence and bargaining between powerful and sophisticated actors against a background of extensive state involvement. But the particular character of an individual nation-state adds two other distinctive features, the first to do with the role of law, the second with the allocation of sovereign authority. Nations with advanced capitalist economies are almost universally governed, or claim to be governed, according to some principles of constitutional democracy. The exercise of public power, in other words, rests on legal authority, and this legal authority is made legitimate in turn by appeal to

popular will. Of course by no means all economic regulation is cast in the form of legal rules, but the central importance of the principle of constitutionalism means that the range and form of regulation is deeply influenced by the particular conception of the scope and purpose of law which prevails in any particular community at any particular time. To put the point more technically, the purpose and character of economic regulation is in part a function of the nature of the surrounding legal culture.

Conceptions of the proper role of law are in turn intimately connected with notions about the appropriate allocation of sovereign authority. Economic regulation is practised in a highly developed form in societies combining organization on market principles, domination of many sectors by giant firms, and political rule according to formally democratic principles. The combination of these three features sets up great tensions in the regulatory process, a tension reflected in much of the literature on the subject. Democracy, especially in the Anglo-Saxon tradition, is closely associated with parliamentarianism: that is, with the assumption that a monopoly of legitimate authority flows from the command of popular and legislative majorities. Regulation, on this conception, is a process by which popular and public control is exercised over the workings of private power in the market-place. The idea was well expressed by Gabriel Kolko, one of the most eloquent defenders of American regulation under the New Deal, when he spoke of the regulatory agencies created in that period as 'the outposts of capitalism' designed to control the market-place 'lest capitalism by its own greed, fear, avarice and myopia destroy itself.'

The notion that economic regulation is a process by which sovereign public authority disciplines and controls private interests has exercised a particularly strong influence over American thinking about the subject. Since the literature on regulation, in the English language at least, is largely American inspired, the notion has in turn deeply influenced debates about the historical development of economic regulation and about its proper place in modern democratic systems. The most important consequence has been an instinctive belief that 'private' influence over the regulatory process is illegitimate. If regulation is assumed to be an activity in which some ideal of the public interest is pursued at the expense of the private, then evidence that private interests benefit from regulation, or that they exercise a strong influence over the regulatory process, is naturally treated as a sign that the purpose of the activity has been distorted.

These notions are particularly marked in the long-running debate about 'capture' in regulation. The very idea of 'capture' betrays an assumption that there is a sphere of public regulatory authority which ought to be inviolate from private influence. Both Kolko's historical interpretation of regulation as a response to the needs of powerful corporate interests, and the vast literature 'exposing' particular instances of regulatory capture, are united by the belief that the practise of regulation has involved the subordination of public authority to sectional interest. Likewise the most influential critique of the interventionist regulatory state produced by a political scientist — Lowi's *End of Liberalism* — rests on the argument that there once existed, and should exist again, a liberal constitution possessing an inviolable public core,

bounded by law, and clearly distinct from the private sphere. Even observers sceptical of 'capture' theories have shared the assumptions of their opponents: debate has typically turned on attempts to rebut the empirical accuracy of capture theory, rather than on attempts to question the assumption that there should indeed exist an inviolable public sphere.

It is undoubtedly the case that arguments about the capture or otherwise of the regulatory process raise important issues of both constitutional principle and substantive outcome. Questions about who benefits from regulation, and who is allowed to shape the decisions made by regulatory agencies, are plainly central to understanding and evaluation. Yet to couch the discussion in terms suggesting the necessity of identifying and defending a clearly delimited sphere of public authority is unhelpful. It rests on the culturally restricted constitutional assumption that the roles of 'public' and 'private' in the regulatory process can be authoritatively distinguished. But as we explore below, there actually exist significant national variations in how the public-private divide is conventionally drawn. More seriously, the 'capture' debate obscures perhaps the single most important feature of economic regulation under advanced capitalism: that the most important actors in the process are organizations, and organizations which, regardless of their formal status, have acquired important attributes of public status. Of the formally 'private'organizations with public status, none is more important that the large firm.

The role of the large firm is unique. Whereas the regulation of the behaviour of individual 'private' actors is concerned with the imposition of a public or general will on private citizens, large firms cannot be described as private 'takers' of regulation in this sense. They have acquired the status of 'governing institutions'. As Lindblom has argued, in a market economy firms carry out functions of an essentially public character. Their decisions on investment, employment, and output have important allocational and distributional implications which resonate in the 'public' sphere. The corporate strategy of individual firms is a major determinant of the direction of the regulatory process. Public governmental agencies do not merely act upon firms as, so to speak, external agents. Corporations are major centres of expertise, and they constitute a significant independent social and administrative hierarchies. Their integration into the implementation of regulation is very often a precondition to success. This is so even where the ownership structure of a firm is independent of a (state) public agency; but the fusion of private and public ownership is actually now a common feature of advanced capitalist economies.

Economic regulation of markets under advanced capitalism can thus be portrayed as an activity shaped by the *interdependence* of powerful organizations who share major public characteristics. In the economic sphere no clear dividing line can be drawn between organizations of a private nature and those entitled to the exclusive exercise of public authority. The fusion is made more complete by one of the features remarked on earlier: economic regulation is an integral part of the activities of the modern interventionist state. While much economic regulation does indeed involve the making of rules and the enforcement of standards, this occurs within a framework of much more diffuse intervention, concerned with a wide range of often

unstated and even contradictory objectives. Economic rule-based regulation is not a distinct activity; it is woven into a larger fabric of intervention. The overall pattern is marked by a high level of social and administrative complexity. In regulation much of the most important activity consists in the routinised application of general principles, which may be devised by the regulatory authority or alternatively may be little more than the company's standard operating procedures, officially endorsed as general principles. Hence we say that certain ways of doing things become 'institutionalised'. At the same time, however, organizational alliances are constantly forming and reforming without any reference to a conventional public-private divide. Parties bargain, co-operate, threaten, or act according to semi-articulated customary assumptions. The allocation of roles between rule makers, enforcers, and bearers of sectional interests constantly shifts, again obeying no obvious public-private dichotomy. In such a world firms are not bearers of some distinct private interest which is subject to public control; they are actors in a common sphere with other institutions conventionally given the 'public' label.

Economic regulation under advanced capitalism is therefore best conceived as an activity occurring in economies where the public and private are characteristically mixed, where the dominant actors are powerful and sophisticated organizations, and where the biggest firms have taken on many of the features of governing institutions. In this world the language of regulatory capture is largely devoid of meaning. Questions about who participates in and benefits-from regulation are certainly important: explaining the complex and shifting relationships between and within organizations at the heart of economic regulation is the key to understanding the nature of the activity. But little can be gained by depicting the relationship in the dichotomous language of public authority versus private interests. On the basis of the evidence collected in this volume we can see that different institutions have come to inhabit a common regulatory space. The central question for the analyst of the European regulatory scene is not to assume 'capture', but rather to understand the nature of this shared space: the rules of admission, the relations between occupants, and the variations introduced by differences in markets and issue arenas. The character of regulatory space is our next theme . . . .

The concept of 'regulatory space' is an analytical construct. It is defined . . . by the range of regulatory issues subject to public decision. A number of obvious consequences follow from this. First, precisely because it is a space it is available for occupation. Secondly, because it is a space it can be unevenly divided between actors: there will, in other words, be major and minor participants in the regulatory process. Thirdly, just as we can identify a general concept of regulatory space in operation in a particular community we can also speak of specific concepts of regulatory space at work in individual sectors: in pharmaceuticals, for instance, issues of safety and price control are subjects, or potential subjects, of regulatory activity, whereas in the automobile sector only the former set of issues are included. Fourthly, because 'regulatory space' is an image being used to convey a concept, it can be augmented by similar images: thus because an arena is delineated space we sometimes speak of a 'regulatory arena'. The boundaries which demarcate regulatory

space in turn by a range of issues, so it is sensible to speak of regulatory space as encompassing a range of regulatory issues in a community. In these terms regulatory space may be furiously contested. Its occupants are involved in an often ferocious struggle for advantage. Any investigation of the concept involves examining the outcomes of competitive struggles, the resources used in those struggles, and the distribution of those resources between the different institutions involved. In other words, the play of power is at the centre of this process.

Discovering who has power in regulation involves paying close attention to the relations between the organizations which at any one time occupy regulatory space. But the idea of a space also directs us to a far more important aspect of power. It encourages us not only to examine relations between those who enjoy inclusion, but also to examine the characteristics of the excluded. That the structure of power is shaped by modes of exclusion from any political process is an elementary truth. In the case of economic regulation, however, the observation has a particularly sharp point. When we speak of the politics of economic regulation under advanced capitalism we are speaking of a set of power relationships dominated by large organizations. These complex organizations – the biggest firms, representative associations, regulatory agencies, central departments of state – are organised in administrative hierarchies whose method of doing business is shaped by standard operating procedures. Institutional procedure, that is, the routine application of established practices, rather than individual choice, is the dominant influence in deciding who is taken into, or kept out of, regulatory space. Since the rules of organizational life have a routinised character, exclusions tend to be systematic. Understanding who is in, and who is out, is therefore particularly vital, and depends crucially on analysing the customary patterns of organizational relationships in any particular regulatory space.

If groups can be organised into, or organised out of, regulatory space, the same can be said of issues. There are no obvious natural limits of boundaries to regulation. Notions of what is 'regulatable' are plainly shaped by the experience of history, the filter of culture, and the availability of existing resources. The fact that economic regulation is predominantly regulation by and of large organizations means, however, that notions about appropriate scope are routinised, and are embedded in organizational procedures. Understanding why some issues are prioritised, included, or excluded, at different times and in different places, thus demands an exploration of how organizations become committed to, and maintain a commitment to, particular definitions of the scope of regulatory space. Likewise, understanding changes in the notion of what issues should be included demands attention to the shifting balance of power within and between institutional actors inside the common regulatory space.

The factors determining the shape of this space, and the relative position of its occupants, are many and complex. But the gist of understanding lies in one simple observation: the most important relationships in economic regulation are relationships between organizations. . . . Here only a sketch of the main influences can be offered [which are place, timing and organisational structure.] . . .

National Peculiarities: ... Regulation occurs, it is a truism to observe, in particular places, and therefore place matters. The most important delineation of place is provided by the boundaries of the nation-state. Nations arrange their regulatory spaces in distinctive ways ... [A]lthough the economies of advanced capitalist nations exhibit similar patterns of extensive regulation dominated by a small number of large organizations, there exist significant national variations in the political and constitutional responses to these similarities. Different national traditions conceive of the public-private authority in different ways; and different national traditions likewise allow access to regulatory space to different constellations of actors. The differences are summed up in the importance given to concepts of legal and political culture. Though some argument exists about the independent explanatory power of cultural variables, there can be no doubt that they are at the very least important in mediating the influence of historical experiences ... In regulation, culturally formed assumptions about the purpose and role of law are particularly significant. These assumptions can determine whether regulation happens at all, its scope, how far it is embodied in statute or formal rules, and how far the struggles for competitive advantage which are a part of the regulatory process spill over into the Courts ....

One of the most striking illustrations of the significance of these kinds of variables is provided by a comparison of Anglo-American and European conceptions of public law. In the Anglo-American tradition, where a legal concept of the state is either absent or only weakly present, public law been essentially concerned with the pragmatic control of public power, especially of the kind of discretionary power which is embedded in the process of economic regulation. In the UK especially, law has not been viewed as the great interpreter of politics. The continental European tradition, more firmly rooted in Roman law, by contrast assigns a central place to the state both as idea and as institution. This establishes the unique character of public authority in terms of sovereignty and/or function.The jurisprudence of public law, enforced through a distinct and specialised court structure in France and West Germany, is developed independently of private law norms, whereas in the United Kingdom and United States the control of public authority has been characteristically secured through the ordinary courts.

Within these broad traditions, distinct national configurations abound. Vogel has recently explored the striking differences produced by British and American attitudes to the relevance of litigation in the regulatory process, contrasting the detailed rules and adversarial enforcement common in the United States with the discretionary guidelines and co-operative implementation characteristic of so much British regulation. Within the European tradition very different national patterns also exist. In France the ideal of a unitary state and the 'paternalistic conception of a prerogative police power, conceived as the general regulation of French society for the public good' still permeates public law theory and practice. The constitution is viewed, not so much as a source of legitimate authority, but rather as an expression of the idea of the unity of the state. In such circumstances, especially in the sphere of economic regulation, administrative courts are considered to be of relatively limited value in

challenging the rulings of administrations 'addicted to discretionary adaptation of the rules to suit the political convenience of governments'. This truncated approach to constitutional values is reflected in public law procedures and norms. The administrative courts may review the legality of a decision but will not, except in very unusual circumstances, substitute their own evaluation of the facts for that of an administration. The Council of State — the highest administrative 'court' — has indeed consistently refused to interfere in economic decisions involving the exercise of discretion,

The place of the constitution and constitutional values in shaping the practice of regulation in West Germany stands out in sharp contrast. The Basic Law of 1949 is viewed as embodying a juristic idea of the state. When combined with Roman law traditions of deductive legal reasoning from a unified set of principles, this has meant that the 'constitution has acquired an imperative character and policy has become highly judicialised'. The West German Constitution is seen 'not just as a general framework establishing a minimum consensus about certain principles' — in the manner of, for instance, the American Constitution — but as a 'political programme containing particular substantive goals'. This commitment to legalism and formalism has limited the exercise of executive power and given the Courts a prominent role in controlling the scope of regulatory activity and the range of regulatory discretion. Equipped with highly generalised constitutional principles such as the right to equal treatment the freedom to own property, and the freedom to pursue a profession, the German Courts have not hesitated to invalidate both administrative regulation and legalisation.

This sketch illustrates some of the important ways in which the character of a legal culture mediates the regulatory process, fixing the scope of regulatory space and influencing who gains entry and on what terms. Variables attributable to distinctive legal cultures may also determine the ability of 'excluded' interests to challenge the existing distribution of power within the common regulatory space. Legal culture may further operate as an important variable in determining the way in which the different rules interact to create a regulatory framework. For instance, the interplay of rules established by statute or collective bargaining and the rules established by statute or common law in the regulation of labour markets, varies considerably between the large European democracies. Similar variations exist in financial regulation: some disclosure practices which are simply the standard operating procedures of large firms in the UK have become 'juridified', or expressed as legally binding rules, in the USA . . .

Historical timing: . . . Regulation is practised in time as well in space. The historical timing of regulatory initiatives and development can thus be critical. . . . The significance of timing arises from an elementary characteristic of regulation as an activity: it has to be organised. Without appropriate institutional arrangements implementation simply does not take place. The act of organization in turn demands resources: the knowledge to create or to copy regulatory institutions; the money and people to run those institutions; the expertise to devise rules, and to monitor and police their enforcement. The organization that controls these resources will

dominate regulatory space; and the organization that commands the necessary resources at the historical moment when regulation is initiated has a good chance of exercising a continuing dominant influence . . . .The significance of timing is emphasised by the nature of regulation itself. Regulation is largely a matter of organizational routine, of institutionalised procedures punctuated by occasional crises, economic or political. Such crises serve the function of inducing change, or at least initiating a search for alternative institutional arrangements. In between periods of crisis, the more dominant organizations can retain and consolidate their position of superiority, so that alternative mechanisms of regulation are ignored or suppressed. The moment of historical origin of regulation can thus be of the utmost significance . . . Regulation almost always happens because some sense of crisis is precipitated, but the crisis can occur at very different historical moments. . . . The balance of institutional forces at the moment of crisis is plainly of enduring importance. In some sectors at the crucial initial moment the state command the necessary regulatory resources, and its own agencies or actors dominate the process. . . . The key analytical point is that understanding regulatory arrangements in the present depends on understanding the historical configuration out of which they developed. . . .

Organizational structure: Economic regulation is predominantly regulation by and through organizations. In any particular arena the character of these organizations will vary; the variations in turn influence the nature of the activity. The most fundamental effect governs who or what exercises any power in the regulatory process. The everyday practice of regulation of course involves dealings between individuals. But these individuals characteristically only enjoy access to regulatory space because they have some organizational role: as employees of firms, as the voice of an organised interest, as servants of the state. Private citizens rarely have a significant legitimate role in the formulation and implementation of regulatory policy. Intellectuals may occasionally contribute to the shaping of regulatory ideologies, though even in such cases their influence depends heavily on their identification with the organizational bearers of scholarly knowledge, such as universities and professional associations. Individual political entrepreneurs like Nader in the United States can likewise periodically intervene, though as the history of Nader's campaigns indicates continuing influence depends heavily on the ability to embody activity in organizational form.

Organizational status is thus the most important condition governing access to regulatory space. Private individuals who do not perform organizational roles, or who are not bearers of organizational interests, enjoy limited and usually temporary success in any attempt to intervene. Citizens are 'takers' of regulation; organizations are makers and shapers. Very occasionally private citizens may succeed in mounting a successful legal challenge to a regulatory programme, but sustained or permanent participation is precluded.

The organizations typically dominant in regulatory space, whether they are conventionally labelled 'private' or 'public', share important characteristics. They are usually big — in the case of the state and the largest firms very big

indeed – and are marked by the elaborate internal division of administrative labour and extended administrative hierarchies. These features impose both co-operative and conflictual elements on the practice of regulation. When regulatory space is dominated by large, hierarchical bodies regulation inevitably becomes a co-operative matter, because only such a means can it be accomplished. Almost nothing of significance is done in regulation as the result of the actions of any single individual or simple organizational entity. The regulatory task is subjected to an elaborate and elongated division of labour. Even the design and implementation of comparatively simple standards (like the introduction of transparency guidelines to advise doctors on prescribing) depends on co-operation between large numbers of individuals occupying very different roles in the hierarchies of different organizations. This observation merely serves to reinforce one of our earlier points: that the big firms who are major occupiers of regulatory space can in no sense be pictured as mere 'takers' of regulation. Even if they are not explicitly involved in the formal process of rule-making, nothing would happen to promulgated rules without their extensive co-operation.

In economic regulation, therefore, the most important parties are bound together in relations of exchange and interdependence. But, the co-operation enforced by the division of administrative labour should not conceal the way the organizations who inhabit regulatory space are riven by competition and conflict. Indeed the essence of regulatory politics is the pursuit of institutional advantage: the pursuit of advantage in the market-place, measured by indices like market share and profit; and the pursuit of command over the regulatory process itself, as measured by the right to make rules and to command their means of implementation. Regulation – and the rules and distribution of power through which it operates – is always a 'stake' of industrial or political struggle.

Organizational status as a condition of access to regulatory space; large-scale, extended hierarchies; a refined division of administrative labour; enforced co-operation in the implementation of regulation; the relentless pursuit of institutional advantage: these are the most important consequences of the organizational character of economic regulation under advanced capitalism. But of course these shared institutional characteristics still allow for considerable diversity, and this diversity influences not only the allocation of power within the regulatory space but also perceptions of what should be regulated, and how the necessary tasks should be accomplished. Four influences are particularly important: the way organizational procedures impose different views about the substance of regulation; the variations introduced by governmental structure and structure of ownership; variations in the internal cohesion of firms; and variations in the social and cultural cohesion and economic strength of industries and sectors.

[**Overall then**], understanding the nature of the regulatory process in advanced capitalist economies involves, above all, understanding the character of the organizational forms dominant in regulatory arenas. Our sketch shows that the allocation of power and influence within regulatory space is influenced both by legal tradition and by a wide range of social, economic, and cultural factors.

2.4.3 Systems theory

While Hancher and Moran's regulatory space approach tends to emphasise the complexity and contingency of how regulation emerges, it is still very concrete, grounded in history, formal institutions and detailed attention to power dynamics. 'Systems theory', however, is the most abstract of what we are calling institutionalist approaches to regulation. Discussions of exactly what is constituted by a 'system' operate at a very high level of abstraction. So, for example, whereas public choice theorists exploring utilities regulation might investigate the ways in which the regulated industry lobbies regulatory agencies and the legislature in order to secure regulatory benefits, systems theorists might focus on the way in which the economic and political systems communicate (or fail to communicate) with each other.

But although this example gives a regulatory context for applying systems theory, systems theory is more than a theory of regulation. It is rather a theory of society, which builds on biological scientists' accounts of how living organisms self-regulate, and particularly of how they relate to their environment in so doing. The influence of biology may seem arcane, but the important point to take from it is the notion that self-regulation is the starting-point for understanding how systems create order. While this has sometimes been interpreted as veiled prejudice against regulation, it is not intended as such. Rather, it is a descriptive consequence of applying empirical observations about biological systems to social settings.

One of the central findings of systems theory is that systems tend to be closed, self-referential 'spaces' that perpetuate their own existence by a series of operations and a system of language that is only comprehensible internally to those who speak the language of the system and understand its workings. The legal system, for example, uses the language of doctrinal analysis and legal precedent to analyse situations by reference to a code that labels outcomes as either 'legal' or 'illegal', whereas the economic system uses economic analysis and evaluations of efficiency or inefficiency. Legality and efficiency are systemically incommensurable, because the legal and economic systems operate at least partially autonomously from each, and most crucially, can only influence each other *indirectly*. Many traditional approaches to regulation are based on the assumption that legal commands will shape the behaviour of economic and political actors to produce certain outcomes. Systems theory is much more skeptical about this. It views hierarchical legal authority as an external irritant to the economic system: one to which it will respond if it can translate its meaning into terms that make sense within the internal logic of its own system. If we think of a 'system' as something less encompassing than the 'economic system' – say, the health and safety system of the oil and gas industry – this approach may come close to a regulatory space approach, but it is more inclined to focus on systemic logics than on the actions or intentions of individuals or groups. In the following extract from Teubner's early work, he presents law as inherently self-restraining: as a

social practice that regulates self-regulatory mechanisms, rather than regulating the substance of a particular issue, such as health and safety.

Gunther Teubner, '*Dilemmas of law in the welfare state*' (1986)

Why make use of the theory of self-referential systems? . . . What follows for our problematic law and society relation if we reformulate them in terms of self-referentiality? What hypotheses, what recommendations for political-legal action are implied?

The message of self-reference can be clearly distinguished from older versions of systems theory. While classical notions of system concentrated on the internal relations of the elements, searching for emerging properties of the system ("the whole is more than the parts"), modern theories of "open systems" reject the "closed systems approach" and stress the exchange relations between system and environment . . . [The guiding questions of the open system approach are:] How can the system cope with an over-complex environment? . . . How can we explain internal structures as a result of environmental demands? . . . In what way are inputs processed into outputs through an internal conversion process? . . .

In a sense, the theory of self-referential systems seems to return to the concept of a closed system, even to a radical concept of closure. *A system produces and reproduces its own elements through the interaction of its elements* — by definition, a self-referential system is a closed system. However, what makes the theory more promising than both its forerunners is the inherent relation of self-referentiality to the environment.

Self-referential systems, being closed systems of self-producing interactions, are, necessarily at the same time, open systems with boundary trespassing processes. And it is precisely the linkage between internalizing self-referential mechanisms and externalizing environment exchange mechanisms which makes the concept of self-reference more fruitful and more complex than its predecessors with their somewhat sterile alternative of closed versus open systems.

If we are using self-referentiality as the criterion to judge competing strategic models of post-instrumental law, two directions of analysis seem to be fruitful. One concerns the question about what effective *limits* the self-referential structure of social systems sets to legal intervention. The second direction of analysis concerns the *social knowledge* which is necessary if law acting within those limits seeks to cope with self-referential structures of the regulated areas. Thus, we arrive at the following theses if we reformulate the premises of the competing strategic models in terms of that theory:

1. *The Regulatory Trilemma*: The implementation strategy will ultimately run aground on the internal dynamics of self-referential structures of both the regulating and the regulated system. Without taking into account the limits of "structural coupling", it inevitably ends in a trilemma: it leads to either "incongruence" of law and society, or "over-legalization" of society, or "over-socialization" of law. Moreover, the models of causal linearity which the implementation strategy uses seem to be insufficient for the social knowledge that is required for the "regulation" of autopoietic systems.

https://doi.org/10.1017/CBO9780511801112.003 Published online by Cambridge University Press

2. *Social Self-Closure*: The re-formulization strategy neglecting in its turn the need of self-referential systems to externalise, develops no obstacles against the dynamics of social self-closure. An increase in subsystem rationality may be the result, but with possibly disastrous effects with regard to the coordination with the system's environment.
3. *Response to Self-Referentiality*: In contrast, the third strategic model seems to be compatible with the self-referentiality. As we have seen, for the control of self-regulation, theorists have developed a broad range of rather diverse recommendations about the way to "proceduralise" the law. Now, in the light of self-referentiality, what seem to be obviously heterogeneous recommendations can be interpreted as complementary strategies. The maintenance of a self-reproductive organization needs societal support. The recommendations can be read as strategies to make compatible the self-referentiality of various social sub-systems. "Proceduralization" represents society's response to the needs of self-referentiality: "autonomy", "externalization", and "coordination".

If we translate our problem of legal regulation into the language of self-reference, a decisive difference becomes apparent. Models of regulation and of implementation, even if they are developed in the open system framework, deal with the implicit assumption of basal linearity. This means, that they see the relation between the regulating systems (politics and law) and the regulated system (functional subsystems, organization, interaction) as a relation between environment and system in which the regulating systems maintain and control the goals and the processes of the regulated systems ... While it is true that they abandon a purely instrumentalist model and take into account autonomy in the regulated area and complicated interaction processes in the implementation field, they still have no adequate concept of what constitutes the autonomy of the regulated system. They still conceive of the regulated system as "allopoietic", as dependent on the actions of the regulating system.

In contrast, a theory of self-reference would define the regulated area as a system consisting of elements which interact with each other in such a way that they maintain themselves and reproduce elements having the same properties as a result of repeating the self-producing interaction. They are systems that keep their reproductive organization constant. To be sure, their concrete structures can be influenced and changed by regulation, but only within the limits of that reproductive organization ... [R]egulations do not at all change social institutions, they produce only a new challenge for their autopoietic adaptation. Any external regulatory influence which leads to a new internal interaction of elements not maintaining its self-reproductive organization, is either irrelevant or leads to the disintegration of the regulated system.

The picture becomes more complicated if we take into account that the regulating systems, politics and law, are themselves reproductive systems. We have then to reformulate the hierarchical relation of regulation into a circular interaction between

three self-referential systems (law, politics, regulated subsystems). The limits of regulation are then defined by the threefold limits of self-reproduction. *A regulatory action is successful only to the degree that it maintains a self-producing internal interaction of the elements in the regulating systems, law and politics, which is at the same time compatible with self-producing internal interactions in the regulated system.* This threefold compatibility relation may be called "structural coupling". Thus, we can formulate the *regulatory trilemma*: If regulation does not conform to the conditions of "structural coupling" of law, politics and society, it is bound to end up in regulatory failure. There are three ways regulation can fail:

(a) *"incongruence" of law, politics and society*

The regulatory action is incompatible with the self-producing interactions of the regulated system – the regulated system reacts by not reacting. Since the regulatory action does not comply with the relevance criteria of the regulated system, it is simply irrelevant for the elements' interactions. The law is ineffective because it creates no change in behaviour. However, the self-producing organization remains intact, in law as well as in society. This is what one might call the "symbolic use" of politics and law.

(b) *"Over-Legalization" of society*

Again, the concrete self-producing interactions within law, politics and within society are not compatible with each other. In this case, however, the regulatory action influences the internal interaction of elements in the regulated field so strongly that their self-production is endangered. This leads to disintegrating effects in the regulated field ... The regulatory programmes obey a functional logic and follow criteria of rationality which are poorly suited to the internal social structure of the regulated spheres of life. Law as a medium of the welfare state works efficiently, but at the price of destroying the reproduction of traditional patterns of social life.

(c) *"Over-Socialization" of Law*

A third type of regulatory failure should be taken into account. Once again incompatibility of self-production is the result of regulation, but in this case with the difference that the self-producing organization of the regulated area remains intact while the self-producing organization of the law is endangered. The law is "captured" by politics or by the regulated subsystem, the law is "politicised", "economised", "pedagogised" etc. with the result that the self-production of its normative elements becomes overstrained. Overstrain of the law in the welfare state may be the effect of its political instrumentalization, but it may also be the law's "surrender" to other sub-systems of society at the cost of its own reproduction. The "over-socialization" of law may take on many forms.

All in all, these three types of regulatory failure which each show very distinctive features have one thing in common. In each case, regulatory law turns out to be ineffective because it overreaches the limitations which are built into the regulatory process: the self-referential organization of these systems, of either the regulated field, or politics or the law itself. The effects are likewise problematic, being either

irrelevance of regulation or disintegrating effects in the self-reproductive organization of law, politics or society.

. . .

Up to this point, we have discussed how law reflects two basic needs of self-referential subsystems: the need for autonomy and the need for externalization. A third dimension becomes apparent if one takes into account that not only social subsystems but also the encompassing society as a whole constitutes a self-referential system. The interaction of the functional subsystems, politics, economy, law, education, religion, family etc. can be seen as a self-producing interaction between elements of a larger system. Each of these subsystems contributes to the maintenance of societal self-reference. The law's contribution in this respect is the resolution of inter-system-conflicts by a specific "procedural regulation". Helmut Willke has developed a concept of a legal programme aiming at this function: the "relational programme". As opposed to the typical programmes of formal law (conditional programme) and of instrumental law (purposive programme), the function of relational programmes is to make compatible different purposes and rationalities of social sub-systems by committing political and social actors to discursive procedures of decision-making. He identifies the emergence of this new type of legal programme in diverse inter-system-coordination mechanisms, such as the . . . Science Council in the Federal Republic of Germany. As Mayntz puts it: "It is in fact an aim of procedural regulation at the supra-organizational level to set up such networks or to provide platforms for such coordination which, where no hierarchical relationships of dependence are involved, will mainly proceed through bargaining".

One promising mode of understanding the working of such "relational programmes" can be found in the theory of "black-boxes" developed in the context of cybernetics. Self-referential systems – social systems like law, politics and regulated subsystems – are like "black boxes" in the sense of being mutually inaccessible to each other. One knows the input and output; the conversion, however, remains obscure. Now, black-box-techniques do not aim at shedding light onto this obscure internal conversion process, but circumvent the problem by an indirect "procedural" activity. They concentrate, not on the internal relations within the black box, but on the interrelation between the black boxes. Black boxes become "whitened" in the sense that an interaction relation develops among them which is transparent for them in its regularities. So law still cannot intervene directly into the economy; legal access consists in the relation between law and economy. It is the peculiarity of relational programmes that they regulate internal processes in systems indirectly so that they concentrate on the relations between the systems. That means again to drastically decrease the requirements of cognitive capacities of law and politics, since they no longer attempt to directly influence economic action but to influence only the "concerned action", whose internal structure is for them much more transparent. It is crucial that between the interaction relation and the regulated system (in our example, between concerted action and economy) consists a dense connection

> which is the course for guidance effects. This is to be expected from two mechanisms. One is the commitment of economic actors in the concerted action and the other is that the concerted action as such develops cognitive modes of the economy which may be more adequate than those of politics and law. This whole way of thinking . . . [suggests that] one has to give up concepts of comprehensive social planning since they are utopian and unrealistic and replace them by more realistic models in which limited strategic knowledge is combined with social interaction, that is in our concept the interaction between the two black-boxes in order to reach guidance effects within one of the black-boxes.
>
> Autonomy, externalization and coordination – these are three dimensions in which reflexive law responds to the basic needs of self-referential systems. These dimensions have been analyzed by different legal theorists with the intention of pointing out the developmental tendencies of post-instrumental law. With the concept of self-referentiality I have tried to demonstrate that they represent complementary rather than competing approaches.
>
> . . .
>
> [This approach] stress[es] the aspect of enhancing specific learning capacities in decentralised social subsystems. These learning capacities should be oriented toward re-introducing the consequences of actions of social sub-systems into their own reflexion structure.

2.4.4 The role of law in institutionalist approaches

Law once again continues to play a facilitative role in institutionalist theories of regulation and, in all the approaches surveyed here, this role takes on a proceduralist dimension. In Ayres and Braithwaite, law might help to create and maintain the tripartite structure that brings together public and private actors, for example by mandating third-party participation in regulatory rule-making. Hancher and Moran, in their own words, argue that, 'the character of a legal culture mediates the regulatory process, fixing the scope of regulatory space and influencing who gains entry and on what terms'. For Teubner, 'the law's contribution . . . is the resolution of inter-system conflicts by procedural regulation', which he stresses is not only a matter of fostering a dialogue between regulatory actors, but also of understanding that regulatory actors operate in semi-autonomous social sub-systems. Despite the very different background theoretical assumptions of our 'grab-bag' of approaches, they can all be seen as fleshing out the image of law as umpire. This image was briefly introduced in relation to procedural political approaches such as Prosser's but is arguably central to institutionalist theories of regulation.

2.4.5 Discussion questions

1. Is Ayres and Braithwaite's approach helpful for understanding how and why regulation emerges? Or is it more applicable to compliance with already existing regulatory regimes?

https://doi.org/10.1017/CBO9780511801112.003 Published online by Cambridge University Press

2. Ayres and Braithwaite could be thought of as trying to blend public and private interest approaches while keeping them less complex than other institutionalist approaches. They do this in particular by creating a 'triangle/pyramid' image of the regulatory space rather than a network. How would we decide which actors should legitimately represent the apex of the triangle?
3. What would Ayres and Braithwaite advise where there is no overlap between mutual empowerment and individual gain? (i.e. when the conditions of 'efficient capture' do not prevail?)
4. Since a regulatory space approach de-emphasises the state, does this make it particularly suitable for exploring regulation in an international context where there is no global government?
5. Can you think of concrete ways in which the design of a regulatory regime could achieve what Teubner calls 're-introducing the consequences of actions of social sub-systems into their own reflexion structure'?
6. Does systems theory tell us anything about regulation that regulatory space approaches do not?
7. Consider political debates about regulation of smoking in public places, gambling and drug legalisation from the perspective of public interest, private interest and institutionalist theories. Do they help in deciding whether regulation is a good idea?

2.5 Conclusion

The relationship between the three broad categories of theories of regulation surveyed in this chapter could take many forms. For example, one could argue that public interest theories place an emphasis on the goals, functions and values that justify regulation; private interest theories are concerned with explaining why regulation emerges and why it takes the forms it does; and institutionalist theories focus on the process of how regulatory institutions work, drawn from an understanding of implementation dynamics but with considerable implications for explaining how regulation emerges in the first place. Alternatively, the literature surveyed in the chapter could be viewed as a series of assertions by public interest theorists, counter-assertions by private interest theorists backed by explanatory models, and attempts (that we have collectively labelled 'institutionalist' theories) to blend the best of these traditions in hybrid forms that reflect current empirical complexities. The relationship between the theories may take multiple forms, depending on the purpose of the enquiry, and the discussion questions have attempted to point readers to some lines of enquiry that would help explore the possible relationships.

The role of the law underpinning each class of theory differs according to the chosen theory. The role of law as authoritative rules backed by coercive force, exercised by a legitimately constituted nation (democratic) state, has been introduced here primarily as a facilitative one, instrumental to achieving

collective public purposes. Both public and private interest theories accord at least a thin role to law in facilitative terms, by constituting the framework within which the collective goals of a regulatory regime are pursued. Private interest theory, however, evinces a considerable degree of skepticism about the likelihood that law's facilitative role will be beneficial if it extends *beyond* a role of constituting a market. Some public interest theories are more optimistic about regulation's capacity to promote collective welfare and link that capacity, at least implicitly, to *law's* ability to facilitate the achievement of those goals. Procedural political approaches — exemplified by Prosser in this chapter — the weight of responsibility placed on law's facilitative role, by limiting it to a procedurally focused contribution.

Institutionalist approaches, our third category of theories, tend to downplay law's role in directly controlling the pursuit of regulatory goals, emphasising non-legal organisational and systemic dynamics as crucial to regulatory trajectories. In the context of densely interwoven networks of public and private actors, the state's role shifts away from that of interventionist controller (whether benignly or malignly viewed) to one of moderating private and public policy interests. Law's role in this context is to structure the interactions between regulatory participants rather than directly to shape the substance of the regulatory issue. Law performs a coordinating function, one element in a reflexive process of influence and change within a regulatory space, system or network. Throughout this chapter, we have explored the facilitative dimension of law's role in regulation and introduced the notion that an umpiring image is one important aspect of that dimension. The facilitative dimension of law's role may, however, produce a rather different image — that of law as threat. It is this image of law as threat to which we turn in the following chapter, in the course of examining regulatory instruments and techniques.

References

Ayres, I. and Braithwaite, J. 1992. *Responsive Regulation: Transcending the Deregulation Debate*, Oxford: Oxford University Press.

Becker, G. S. 1983. 'A theory of competition among pressure groups of political influence', *Quarterly Journal of Economics* 98: 371–400.

Croley, S. 1998. 'Theories of regulation: Incorporating the administrative process', *Columbia Law Review* 1: 56–65.

Freedman, J. O. 1978. *Crisis and Legitimacy*, Cambridge: Cambridge University Press.

Habermas, J. 1979. *Communication and the Evolution of Society*, Oxford: Heinemann.

Hancher, L. and Moran, M. 1989. 'Organizing regulatory space', in Hancher, L. and Moran, M. (eds.), *Capitalism, Culture and Regulation*, Oxford: Clarendon Press.

Kolko, G. 1967. *The Triumph of Conservatism*, Chicago: Quadrangle Books.
Lowi, T. J. 1969. *The End of Liberalism: Ideology, Policy, and the Crisis of Public Authority*, New York: Norton.
Mayntz, R. 1983a. *Implementation Politischer Programme II*, Opladen: Westdeutscher Verlag.
1983b. 'The changing conditions of effective public policy — A new challenge for policy analysis', *Policy and Politics* 11: 123—143.
Meidinger, E. 1987. 'Regulatory culture: A theoretical outline', *Law and Policy* 9(3): 355—386.
Niskanen, W. 1998. *Bureaucracy: Servant or Master? Lessons from America*, London: Institute of Economic Affairs.
Ogus, A. 2004. *Regulation: Legal, Form and Economic Theroy*, Oxford: Hart Publishing.
Prosser, T. 1986. *Nationalised Industry and Public Control: Legal, Constitutional and Political Issues*, Oxford: Blackwell.
Sunstein, C. 1990. *After the rights revolution: reconceiving the regulatory state*, Cambridge (MA): Harvard University Press.
Teubner, G. (ed.) 1986. *Dilemmas of Law in the Welfare State*, Berlin: Walter de Gruyter.
Willke, H. 1983. *Entzauberung des Staates*, Königstein: Athenäum.

Suggested further reading

Black, J. 2000. 'Proceduralizing regulation Part I', *Oxford Journal of Legal Studies* 20: 597—614.
2001. 'Proceduralizing regulation Part II', *Oxford Journal of Legal Studies* 21: 33—58.
Brans, M. and Rossbach, S. 1997. 'The autopoiesis of administrative Systems: Niklas Luhmann on public administration and public policy', *Public Administration* 75: 417—439.
Dunsire, A. 1996. 'Tipping the balance: Autopoiesis and governance', *Administration and Society* 28(3): 299—334.
Dyson, K. 1980. *The State Tradition in Western Europe*, Oxford: Martin Robertson.
Farber, D. and Frickey, P. 1991. *Law and Public Choice: A Critical Introduction*, Chicago: University of Chicago Press.
Fels, A. 1982. 'The political economy of regulation', *University of New South Wales Law Journal* 5: 29—60.
Freeman, J. 1999. 'Private parties, public function and the real democracy problem in the new administrative law', in Dyzenhaus, D. (ed.), *Recrafting the Rule of Law*, Oxford: Hart Publishing, 331—370.
Grabosky, P. and Braithwaite, J. 1986. *Of Manners Gentle: Enforcement Strategies of Australian Business Regulatory Agencies*, Melbourne: Oxford University Press.

James, O. 2000. 'Regulation inside government: Public interest justifications and regulatory failures', *Public Administration* 78: 327–343.

King, M. and Schutz, A. 1994. 'The ambitious modesty of Niklas Luhmann', *Journal of Law and Society* 23: 261–287.

Lange, B., Haines, F. and Campbell, D. (eds.) 2003. 'Regulatory spaces and interactions', Special Issue, *Social and Legal Studies* 12(4): 411–545.

Nelken, D. (ed.) 2001. *Law's New Boundaries: Consequences of Legal Autopoiesis*, Aldershot: Ashgate.

Noll, R. and Owen, B. 1983. *The Political Economy of Deregulation: Interest Groups in the Regulatory Process*, Washington DC: American Enterprise Institute.

Picciotto, S. and Campbell, D. (eds.) 2002. *New Directions in Regulatory Theory*, Oxford: Blackwell Publishing.

Prosser, T. 1999. 'Theorising utility regulation', *Modern Law Review* 62: 196–217.

Scott, C. 2001. 'Analysing regulatory space: Fragmented resources and institutional design', *Public Law* 283–305.

Stewart, R. B. 1975. 'The reformation of American administrative law', *Harvard Law Review* 88: 1669–1813.

Stigler, G. 1971. 'The theory of economic regulation', *Bell Journal of Economics and Management Science* 2: 3–21.