

# How are regulations made? From public interest theory to an institutional approach

Gustavo Delvaux Parma<sup>a</sup>.

<sup>a</sup> National Faculty of Law, Federal University of Rio de Janeiro, Rio de Janeiro, Brazil, [parmagd@gmail.com](mailto:parmagd@gmail.com).

**Abstract.** Governmental regulatory activity impacts us daily, but mostly we do not even notice it. Probably nearly every product in our households has been affected by some state regulation, but most common citizens know almost nothing about how the regulatory process works. Therefore, the aim of this paper is to analyze the major works about how regulations are made. It is important to notice that this work does not have the objective of reviewing legal norms that indicates how regulatory processes work in one country or another, but to evaluate how public or political agents (regulators) tend to work, i.e., what tends to dictate their behavior, how lobbying activities affect regulation, what role do institutions have. To achieve its aim, the paper uses a methodology based on literature review. It was found that it is commonly assumed that regulators pursue society's public interest, but many scholars have criticized this view over the years. One of the major schools of thought that opposes such assumption is the Public Choice. Even if many works have been conducted within the framework of the Public Choice school, it is possible to say that its major basis is the idea that public agents tend to pursue their own interests. The Theory of Economic Regulation was created among Public Choice scholars and assumes that industries that have enough power to buy legislation from politicians will most likely do it by providing votes and resources. Even so, other works have suggested that we cannot only assume that a regulator's private interest will be the only factor that affects his behavior. The paper then also analyzes some works based on an institutional approach. This view aims in also studying how the regulatory institutions work (and not only individuals) and how external institutions may influence the regulatory process. The paper concludes by stating that we cannot be overly idealistic or too skeptical. Even if as general rule it is not possible to deny that most regulators are usually also influenced by their own private interests, it is also possible to value public interests within the government through institutional design.

**Keywords.** Public Law; Regulation; Public Choice; Public Interest Theory; Interest Group Theory.

## 1. Introduction

As Otto von Bismarck once supposedly said, "laws are like sausages, it is better not to see them being made".

And, even if it is impossible to be sure about the origin of such a claim (or even if Bismarck has ever said those words) [1] this kind of criticism towards the legislative process is emblematic.

It is usually not hard to find a disillusioned stance among the population regarding politics and the law-making process in general. According to the Global Trustworthiness Ranking 2021, for example, politicians and government ministers are usually the least trusted groups by societies around the world [2].

But even so, politics play a key role in our societies.

Government activities regulate our lives to levels we sometimes do not even notice. Therefore, going in the opposite direction from Bismarck's supposed line, many scholars from social sciences, economics and law have aimed to explain what dictates the behavior of public authorities.

In other words, many studies have tried to explain how regulators act and what dictates their behaviors. Here the term "regulators" should be understood in a broad perspective, as it can mean from legislators to members of regulatory Executive agencies.

Therefore, considering the importance of knowing how our government officers work, this paper aims to summarize the main theories on the behavior of public officials within their regulatory activities. It is outside of the scope of this paper to analyze self-regulation within private institutions.

## 2. Research Methods

To achieve its goal, this paper used a literature review on the subject.

## 3. The main theories

### 3.1 Public Interest Theory

The public interest theory is one of the most traditional regarding the matter. It basically establishes that regulators act based on the protection and benefit of the public; that markets tend to fail; and that regulation has zero transaction costs.

It might sound too naïve to assume that regulators act solely based on society's interest. And is because it is. The public interest theory is usually more assumed than actually articulated.

The concept of public interest itself is very traditional and exists since political philosophy took its first steps. It has played a key role in the justification of the legitimacy of the government and still plays, as public interest is closely related to the realization of political and moral values within the public sphere.

Therefore, public interest might be read as part of a posture on what the aims of the state should be. For this reason, public interest has been used as a concept to support regulation politically and philosophically, but no author has ever claimed to be part of the so-called Public Interest Theory.

That is why it has been stated that there is no structured theory called Public Interest Theory [3].

Even if concerns with the public interest are usually addressed in the public sphere, there are no scholars claiming that regulators always (or at least more often) act based solely on the basis of concerns for the general public, and for this reason it has been argued that there is no such as thing as a Public Interest Theory.

Even so, as public interest concerns are inseparable from the trajectory of our current political thoughts, it is important to address the so-called Public Interest Theory and its counterpoints.

### 3.2 Public Choice School

The Public Choice School aims to describe political science through economics methods. It applies behavioral elements in order to work with the assumption that political and public agents always try to increase their own interests. In other words, that would mean that they always try to maintain their power and, preferably, increment it.

According to this school of thought, politicians would follow a certain agenda not because they have a great concern towards public interests, but because it is how they might gain votes in the next elections and perpetuate in power.

Two major kinds of incentives would apply to public agents within the framework of the Public Choice School: (i) an internal one, made by advantages that politicians might gain from within the political system, e.g., positions that may provide advantages, such as the power to veto certain projects; and (ii) external incentives, in which regulators might gain or maintain power by complying with private groups interests, e.g., voters or big private companies [4].

Those are the major and most basic elements of the Public Choice School, but it is important to keep in mind that it is a very rich topic and many other scholars have provided valorous inputs within it and therefore many other sorts of incentives on public agents have been documented. Many other regulation theories have been made within the framework of Public Choice, as it will be addressed now.

### 3.3 The Theory of Economic Regulation

The Theory of Economic Regulation was developed within the scope of the Public Choice School. Its landmark is the homonymous paper written by economist George Stigler.

Stigler argues that, as a rule, regulations are made with support from the industry and are designed to work for its benefit. This would be due to the coercive power that the state possesses. By "purchasing" state regulations, the industry would be able to support a law that imposes entry barriers and restricts the entry of new competitors within a relevant market or subsidies of money, for example.

The regulation would be obtained by the industry through two different ways: (i) votes, gained through information disclosure programs among the industry or other concerned industries; and (ii) resources that might be given to the supported party, such as campaign contributions or other services.

Basically, Stigler's main point is that any industry that has enough power to do it will at least try to obtain competitive advantages through the legislative process. And, due to the fact that political campaigns are usually costly and competitive, most parties are willing to be influenced by those lobby activities.

Of course, this assumption does not imply that most political parties are willing to do anything for economic advantages, but only that their activities might be greatly influenced by the industry.

And why would electors let this situation take place? A regulation that restricts competitiveness within a market also tends to decrease consumer's welfare. Stigler's answer is that it is too costly for the average citizen to keep himself constantly updated on the political discussions. So, most people are not even aware that those situations occur [5].

Stigler's paper was the first step of the Theory of Economic Regulation, a framework within the Public Choice School. Regardless of its historic importance,

it is possible to criticize it for being overly simplistic. There is no question that industries play a key role in the legislative process, but surely there are other factors that influence how a regulation is made. Many laws that impact industries negatively are constantly adopted by different countries, such as environmental statutes or tobacco restrictions, for example.

Within the scope of Public Choice School, many contributions were made to Stigler's initial Theory of Economic Regulation.

For example, Sam Peltzman argued that, even if Stigler's work was groundbreaking, its conclusions still missed key elements. Peltzman then aimed to incorporate marginal gains and costs in Stigler's theory. Basically, protections to a specific industry usually bring costs to consumers. Therefore, complying with the demands of an industry might make politicians lose votes from consumers. Thus, politicians would have to weigh both aspects in order to decide if they will collaborate with a certain industry or not [6].

Now, we shall analyze other theories that aim to explain how regulators act, but this time outside the framework of the Public Choice.

### 3.4 Institutional Theories

Public Choice has often been criticized for being overly skeptical about how public agents act [7]. Do public agents act purely based on their own interests? It might sound reasonable to take this as a common scenario, but surely it is not enough to explain all possible situations. For example, if regulators are only concerned with their own interests, would there be no way for citizens to have their public interests represented?

To answer those questions, many scholars took an institutional approach by trying to understand the institutions that regulators work within.

Institutional independence, for example, plays a key role in regulation making. It has been argued that regulators from regulatory agencies tend to pursue better policies when they are independent from short-sighted politicians. But too much independence might make it easier for regulators to be captured by private interests, so making them accountable by politicians is also desirable [8].

Through independence and accountability, it would also be possible to make regulatory bodies more distanced to their own private interests and closer to the pursuit of public goals.

Empirical studies have also found that countries that have successfully constrained the discretionary power of regulators also have independent and well-regarded judiciaries, as judges are often required to settle disputes on regulatory matters [9].

Therefore, if we want to understand how regulations are made in the real world, it is also important to

understand the institutions that regulators are inserted into. Characteristics such as institutional independence may have great impacts on the decision-making process.

But within a contemporary government no institution works alone. Especially in a separation of power marked by a system of checks and balances, such as it is in most major democracies nowadays, external institutions constantly interfere in the regulatory process. Therefore, it is also important to understand the relation between the different players involved.

## 4. Discussion

One of the key findings of the literature review is that we cannot be overly idealistic or skeptical about how the regulatory process works.

After all, as much as it is certain that regulators do not pursue only the public interest, we can also say that the government would be worthless if we did not have ways to make society's goal be incorporated into the public debate.

Institutional design might be an important tool to value the public interests. Through reforms within institutions, it is possible to incorporate elements that make private interests less likely to interfere in the regulatory process.

This alternative was not found during the literature review, but an interesting mechanism in order to make the regulatory process more democratic is to allow society to have opportunities to express its opinion on matters that are being discussed by public institutions.

In Brazil, for example, regulatory agencies are obligated by law to make a Public Consultation ("Consulta Pública") on matters that may affect economic groups, consumers or users of the services that might be affected. In those consultations any citizen or legal person might give its opinion and, even if the public institution is not obligated to follow it, it must at least give a response to it and make a report with all the contributions that were provided.

This idea did not originate in Brazil and practical problems often take place during those consultations, but, even so, it might be considered a good example of how institutional mechanisms might be created in order to allow public interests to be incorporated into the regulatory process.

## 5. Conclusion

There is a common assumption that public or political agents usually work towards the public interest and this assumption is traditionally relatively usual in social science or political philosophy.

Public Choice School has shown us that this tends to not be true. After all, public agents are still

individuals and therefore they also tend to maximize their own interests.

But if we consider that public and political agents are only capable of pursuing their own private goals or to be influenced by lobbying activities, there would be no point to even establish a government.

So, institutional design might be a great tool to shape the behavior of regulators and make them pursue public interests. Through changes in the institutions that work within our political system, it is possible and likely that this will affect the final result of the regulation making process.

It should also be addressed that many other studies about regulation making have been made and published. The aim of this paper was only to introduce the reader to some of the major findings within this topic. After all, many libraries have been written about this matter and certainly many other will still be written.

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