Testing Theories of Regulatory Behavior

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Abstract. Many decisions by regulators have been analyzed over the last two decades in an effort to test regulatory behavioral theories. As a result, the interest group theory of behavior has gained a considerable following and the public interest theory has been largely dismissed. However, many of these tests are inadequate; with the regulatory decisions analyzed, both the interest group and public interest theories lead to the same predictions. To properly distinguish between these theories, a set of necessary conditions that a regulatory decision must satisfy is developed. Based on these conditions and the extant empirical literature, public interest concerns of regulators cannot be dismissed, and a more general theory of regulatory behavior is suggested.

Key words. Regulatory behavior, interest groups, public interest.

I. Introduction

Do politicians try to promulgate policies that are in the public interest? Economists and political scientists have devoted considerable effort attempting to answer this question. The most prominent theories developed in recent decades predict that government policies follow from the narrow self interests of politicians, rather than from a pursuit of the public interest.1 However, empirical evidence suggests that political behavior is not so one sided. In addition to self interest, ideologies, or the politicians' concepts of the public interest, are useful predictors of political behavior.2

Closely aligned with the literature on political behavior is the literature on regulatory behavior. In the regulatory arena, we can ask whether regulators make decisions in the public interest or in their self interests. Their self interests are associated with the need to strengthen their political support, and this can be accomplished by obtaining resources from the interest groups whose wealth is affected by their regulatory decisions.3 George Stigler's (1971) economic theory, or interest group theory of regulation concentrates on self-interest as the motivating factor, and his theory has gained an impressive following in recent years relative to the all but discarded public interest theory.

The purpose of this paper is to reconsider the role of the public interest in regulatory decisions. In the same way that ideology plays a role in the political process, we show that the public interest plays a role in the regulatory process.
We do not resurrect the public interest theory to see if it can stand on its own. Empirical evidence indicates that it cannot. But we do show that the extant evidence either 1) cannot be used to reject the public interest theory, or 2) supports a general theory wherein both the public interest and interest groups matter.

Point 1) is important and its explanation occupies most of this paper. We show that much of the existing literature does not logically differentiate between the predictions of the public interest and interest group theories; hence, it cannot be regarded as support of either theory over the other. This indeterminacy arises because examining regulatory behavior is done by observing regulatory decisions. Both the public welfare and interest group welfare depend on these decisions, and the public welfare is simply a combination of the welfare of all the interest groups. Because public welfare and the welfare of at least some interest groups are likely to be positively correlated over the range of the regulators' choice set, it may be impossible to determine whether the regulators are favoring the public interest or the interests of select groups. Noll (1989) emphasizes this indeterminacy when he states "... without explicit measures of the magnitude and nature of the net stakes of groups at risk in the vote, they cannot distinguish among alternative theories that are based on interest group analysis."

This indeterminacy also can be seen in the insightful work of Becker (1983). He models interest groups that compete for political influence in order to either receive subsidies or to avoid taxes. Becker's theory does not contain social welfare functions or a benevolent government (i.e., a public interest approach); instead the government implicitly is assumed to respond to political pressure (i.e., an interest group approach) yielding policies that are more likely to raise than lower economic efficiency. But this result is the source of the problem for empirical work aimed at testing theories of government behavior. If a theory containing a benevolent government, and Becker's Theory without a benevolent government, both lead to the same prediction that government policies raise economic efficiency, then we may not find empirical evidence that supports one theory and not the other.

In Section II, we present straightforward models of the interest group, public interest and generalized theories of regulatory behavior. We demonstrate in Section III that the models' predictions will be indistinguishable unless a set of stringent conditions on the regulatory environment are satisfied. Section IV is a discussion of why the general theory is more appropriate in light of the stringent conditions and the extant empirical literature.

II. Theories of Regulatory Behavior

A. POLAR MODELS AND A GENERALIZATION

To formally distinguish between the two theories, we assume that regulators have preferences defined over \( w \) and \( r \) representing public welfare and resources