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REGULATION, POLITICS, AND INTEREST GROUPS: WHAT DO WE LEARN FROM AN HISTORICAL APPROACH?

ABSTRACT: *In* The Regulated Economy: A Historical Approach to Political Economy, *Claudia Goldin and Gary D. Libecap use case studies to defend and expand upon the notion that elements of civil society—"special interests"—manage to "capture" government regulators and make the state serve their selfish ends. The evidence of the case studies themselves, however, and the occurrence of such anomalies as the deregulatory movement, suggest that government actors often enjoy considerable autonomy in regulating civil society, and that readily manipulable currents in public opinion are also important.*

The theory of regulation began with the "public-interest" view, according to which economic regulations are adopted in the interest of consumers, so as to promote the general welfare. For example, early analysis of the regulation of U.S. railroads focused on the role of the Interstate Commerce Commission in reducing price discrimination and monopoly power. According to the public-interest theory, there will be a demand for regulation when the free market subjects consumers to monopoly power or other market inefficiencies. "The state," it might be said, acted as an agent for the good of "civil society."

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This view of regulation was challenged by both historians and economists. In the case of railroads, Gabriel Kolko (1965) argued that historically, regulations were designed to serve the interests of the railroads themselves. This claim was congruent with the modern interest-group theory of regulation, developed by George Stigler (1971) and Gary Becker (1983). Their work emphasizes the ability of organized "special interests" within civil society to influence state policy to their own advantage.

The interest-group theory explores the circumstances under which groups are more likely to organize and, in turn, influence public policy to serve their own narrow ends. Unlike the public-interest view, the interest-group theory does not assume that regulatory outcomes will benefit consumers. Indeed, since consumer interests are likely to be diffuse and not easily organized, the natural tendency should be for regulation to affect consumer interests adversely. However, Becker allows that market failures create opportunities, at least in theory, for positive-sum regulations.

In *The Regulated Economy: A Historical Approach to Political Economy* (University of Chicago Press, 1994), Claudia Goldin and Gary D. Libecap introduce eight historical essays on the development of modern American regulatory structures, focusing on the role of interest groups and politics in the historical genesis of the regulation of railroads, natural gas, banking, immigration, agriculture, and labor, from the nineteenth century through the Great Depression. The essays use a variety of approaches, from statistical analyses of legislative and electoral voting to traditional historical narratives, to put flesh on the Stigler-Becker framework, marshalling a wide range of evidence to highlight the role of the interest groups in the initiation, design, and implementation of economic regulation.

However, in many cases the links between economic interests and regulatory outcomes is indirect at best, undercutting the persuasiveness of the Stigler-Becker framework. It is often quite difficult to provide compelling evidence linking economic interests to specific legislative votes and policy outcomes. Moreover, the histories of regulation in this volume make it clear that an autonomous "state"—i.e., legislators, regulators, and judges acting on their own, not at the behest of any element of civil society—has played an important role in the timing and evolution of regulation in the United States.

The Tenuous Link between Special Interests and State Actions

In popular American discussion, economic regulation is often portrayed as if it were solely the province of the federal government. But by looking at state-level regulation, several of the book's essays show that politics often interferes with the pursuit of economic self-interest posited by the interest-group theory.

In "The Origins of State Railroad Regulation: The Illinois Constitution of 1870," Mark Kanazawa and Roger Noll analyze efforts to regulate railroads in Illinois—efforts that preceded by 20 years the passage of the Interstate Commerce Act, and that were opposed by the railroads. Analyzing votes on a referendum and at a constitutional convention, Kanazawa and Noll show that voters' ballots did not always track their economic interests, as public-choice theorists assume. Often they voted "altruistically." (Kanazawa and Noll also show that producer groups do not necessarily have monolithic interests.)

Werner Troesken's essay, "The Institutional Antecedents of State Utility Regulation: The Chicago Gas Industry, 1860 to 1913," is, at first glance, compatible with the interest-group theory. Troesken shows that vigorous competition in the market for natural gas was thwarted by the Gas Acts of 1897, which, at the behest of established gas companies, had the effect of greatly restricting entry and eventually leading to monopoly provision. But then the story takes a turn that might surprise at least a naïve proponent of the "capture theory" of regulation. Fearing municipal regulation of their monopoly, gas producers pushed for state regulation by means of a state public utility commission. Troesken maintains that gas producers feared that closer monitoring by municipal governments would lead to lower gas prices than would regulation through a more distant state regulatory body, illustrating an old rule of politics: if you are losing in one forum, find a different one. The larger lesson of this tale is that regulation does not always serve the interests of the regulated. In the case of Chicago, the original, industry-serving regulations led to a political reaction that would have undermined the gas monopoly's interests. The state regulation then pursued by the industry was a lesser evil, in the industry's view, than municipal regulation would have been—but it was an evil nevertheless, not an expression of its interests per se.

At bottom, the problem with the interest-group theory—ironically, since it was developed by economists—is that it fails to provide micro-

foundations for the behavior it postulates. In the economy, self-interest is manifested in economizing *behavior* by producers and consumers. Selfish motives aren't enough: there must be mechanisms, such as competition over price and quality, that allow these motives to affect outcomes. But even if we make the heroic assumption that the main motive of all political actors is selfish, we still need to know precisely how they manage to translate their wishes into government actions, such as favorable legislation or the promulgation of specific regulations. In short, just how is "regulatory capture" supposed to work?

Although it is not their primary intent, several essays in this book suggest that often, it doesn't work. In many instances it seems that the links between interest groups and legislation are quite loose, pointing to a role for autonomous political factors in determining the pace and design of regulation, un-"captured" by civil-society interest groups.

In "The Political Economy of Immigration Restriction in the United States, 1890 to 1921," Claudia Golden analyzes what caused America to shift to a more restrictive immigration policy. Goldin demonstrates that relatively high rates of immigration in a given congressional district had two distinct effects. While it lowered the wages of the native born, it also eventually created a pro-immigrant voting bloc. Goldin estimates that once a district was more than 30 percent foreign born, its congressional representative would support continued open immigration. But while the need to obtain votes makes sense as a microfoundation for self-interested legislative behavior, it fails to enable Goldin to predict the timing or nature of immigration restrictions. Goldin argues that a "regime change was inevitable" (256). But the precise timing of this shift over a 20-year period, and the changing political attitudes of the South towards restrictive immigration, are not easily accounted for by her standard model of the influence of voters' economic interests.

On the other side of the interaction between interests and legislators, "Congress and Railroad Regulation: 1874 to 1887," by Keith Poole and Howard Rosenthal, criticizes the naïve assumption that a legislator's roll-call vote reflects her electoral interests alone. The authors show that many factors, including personal conviction, influence legislators and that, in close votes, partisan considerations will often dominate. Thus, Poole and Rosenthal warn, it is risky to make strong inferences from single votes—as many of the papers in this volume do. The link between interests and votes is not that straightforward.

Additional evidence for the autonomous role of political factors and political complexities in regulation is evident in "Political Bargaining and

Cartelization in the New Deal: Orange Marketing Orders," by Elizabeth Hoffman and Gary Libecap. In 1933, to raise the income of farm producers, the U.S. government tried to create agricultural cartels. The Agricultural Adjustment Administration (AAA) was confident that this strategy would be effective, but it did not prove possible to work out stable cartel arrangements. In the market for oranges, heterogeneous interests prevented success. Hoffman and Libecap emphasize that in understanding regulatory regimes, we must go beyond formal legislation and study the implementation process involving agencies and constituents. Despite the AAA's intention to allow the orange industry to use the regulatory apparatus for its own end, the practical difficulties in parceling out the benefits to market participants made this policy unworkable.

Just as important, if not more so, is the role of political persuasion, propaganda, symbolism, and information. For example, in "The Origins of Federal Deposit Insurance," Charles Calomiris and Eugene Nelson White contend that federal deposit insurance was special-interest legislation for states with volatile economies and prohibitions on branch banking—which, they maintain, diversifies economic risks without incurring the moral-hazard problem of deposit insurance (which protects profligate banks against market retribution). Small banks in agricultural areas were particularly vulnerable to downturns caused by local crop failures. Rather than abandoning their prohibitions on branch banking, however—which would have threatened small local banks—agricultural states lobbied for a federal deposit-insurance program.

Despite the onset of the Great Depression, however, the Roosevelt administration and the bank-regulatory agencies initially opposed federal deposit insurance. What turned the tide? Calomiris and White argue that the "nature of the battle over deposit insurance changed in the 1930s from a battle waged in Congress among special interests to one that engaged the public interest. The banking collapse focused the attention of the public on the otherwise esoteric political issue of banking reform" (146). Such politicians as Representative Henry B. Steagall took advantage of the new public sentiment to successfully lead the campaign for deposit insurance.

The Political Regulation of Capitalism

Taken together, these essays point to some key limitations of the standard Stigler-Becker view of group interests and regulation. A number of

important factors intervene between group interests and regulatory outcomes.

First, as several of these papers clearly emphasize, the politics of regulation can and does take place in many different venues. In the United States, the variety of regulatory arenas includes Congress, regulatory bureaucracies, municipal and state governments, and self-regulating business groups. Strategic actors understand this complex landscape and attempt to move decision making to the arenas that are more advantageous to them.

As a rule, narrowly defined economic interests are more effective in legislative settings and smoke-filled rooms than on the public stage, where appeals—however misleading—to the common good are at a premium. As Calomiris and White emphasize, part of Steagall's strategy was to make the nationwide banking collapse a focal issue so as to galvanize public support. Congressional hearings, newspaper editorials, speeches, and other means of swaying public opinion can—at the risk of stating the obvious—be more important than the lineup of interest groups. Nor are interest groups and public opinion necessarily at odds. Public opinion can be swayed when the playing field is widened and new participants enter the debate.

Second, in democracies regulatory battles never really end. Initial legislation is followed either by subsequent legislation or debates over regulatory implementation. As the Hoffman-Libecap and Calomiris-White papers show, regulatory structures and legislation can evolve over long periods of time. As the years pass, the nature of the participants will often vary, giving the losing side a chance to rebound and making it difficult for groups that initially prevail to preserve their advantages.

As the essays in this book make clear, interest groups are important but not definitive in determining the timing and precise substance of regulation. It is simply not the case that narrowly defined economic interests determine outcomes, as naïve practitioners of the Stigler-Becker approach often contend. Interest groups may help frame the debate, but there is plenty of room for autonomous political factors to intervene.

Consider as an example the current debate on Social Security reform. In this debate, interest groups include the current elderly (and near elderly), future workers, Wall Street firms, and the existing Social Security bureaucracy. The debate over the next decade will take place in multiple forums and will involve a variety of tactics. There will be some attempts to narrow the issue, for example, by focusing on the

question of where the government should invest the trust fund or, alternatively, on whether workers should be given an opportunity to make their own decisions about the allocation of retirement funds. And there will be attempts to broaden the issue: for example, by linking Social Security with reform of Medicare. There will also be continuing efforts to change the preferences and attitudes of voters. At the moment, we can recognize the various interests at play, but predicting the precise outcomes is impossible. When the dust settles, we may be able to identify the most successful strategies, but this is clearly in the realm of hindsight, not of predictive political science or economics.

Beyond Case Studies

A reader of the detailed essays in this book would learn quite a bit about the historical political economy of regulation, but would not necessarily be able to link any of these individual regulatory episodes together. Although the term "Progressive era" is mentioned in the essays, it apparently was not significant enough to make it into the index of the book. Is there something beyond an extended Stigler-Becker regulatory approach that ties different episodes of regulation together?

The implicit answer in this book is "no." The volume's case studies span the 60 years prior to the Great Depression and, as we have seen, cover many seemingly unrelated issues. The editors attempt to tie these essays together with a self-conscious effort to broaden the Stigler-Becker approach to the relationship of interest groups to regulation. Nonetheless, the message from this book is to treat each case as a separate instance of this relationship.

Nonetheless, there are hints within the book that broader forces are at work. Wallis, Sylla, and Legler argue that the tax and regulatory structures in banking varied over time and were endogenous to the several states. A number of the authors discuss how the popular referendum, a political tool advocated by Progressive reformers, can shape regulatory outcomes quite differently than would standard statehouse or Congressional politics. And broader national trends were clearly at work in the movements toward stricter immigration laws and toward the adoption of deposit insurance.

To determine if we need to move beyond an analysis of specific case studies to understand the dynamics of regulation, it may be useful to think about the recent movement toward deregulation around the

world. Does deregulation fit into even an extended Stigler-Becker framework, or do we need to look for broader, more comprehensive factors?

Deregulation and State Autonomy

Since the 1970s, there has been a systematic movement towards deregulation. In the United States, we have witnessed deregulation efforts in trucking, airlines, telephone service, banking and financial services, cable television and, more recently, in gas and electric power. In Great Britain, deregulation has been accompanied by privatization in electricity, telephones, and most recently railroads. In our everyday understanding of deregulation, we think of these efforts collectively as a trend in economic management and as part of an overall political movement. Americans trace these efforts back to Presidents Carter and Reagan, Britons to Margaret Thatcher.

Clearly, deregulation was influenced by the work and writings of economists who championed market competition. Some of the more persuasive voices in these debates were those of economists and lawyers affiliated with the University of Chicago. Indeed, it was George Stigler himself, along with the likes of Richard Posner and Sam Peltzman, who highlighted the adverse consequences of existing regulatory structures. Working from the Stigler-Becker interest-group theory of regulation, it was no surprise to these scholars that regulations did not serve the "public interest" but instead were designed to satisfy the interests of the most salient special interests. In the view of many observers, the Chicago school was quite successful in persuading powerful bureaucrats and legislators that deregulation would serve—the public interest. Thus, the same economists who portrayed the state as being dominated by special interests were able to prompt deregulatory efforts that, by their very success, would seem to show that the state is, in many cases, autonomous from those interests—if, for example, government officials become persuaded that those interests are not congruent with the public good.

The ability to provide a plausible account of the trend towards deregulation is an important challenge for the Stigler-Becker analysis of regulation. Let me sketch a general outline of how defenders of that analysis might proceed. They would start from a "regulatory equilibrium" in which existing regulations were consistent with the current

configuration and power of interest groups. They would then posit a technological disturbance or other exogenous factor to disturb this equilibrium. Given the new disequilibrium, interest groups would find the status quo unsatisfactory and maneuver for changes in the existing structure—with the result, sometimes, being deregulation.

On the surface, such an argument confronts a number of immediate problems. First, casual evidence suggests that it was state actors, not interest groups, that were instrumental in several major deregulation efforts. Members of the Civil Aeronautics Board and the economist Alfred Kahn were the prime movers behind airline deregulation, while Harold Green, the judge in the AT&T antitrust case, helped initiate the move towards deregulation in the telephone industry. Moreover, in many cases it is doubtful that the protagonists of deregulation had a clear idea of how the market would evolve and thus whose interests their reforms would serve. For example, did the proponents of airline deregulation envision the onset of dramatic price discrimination between business travelers and vacation travelers, or the hub and spoke system that replaced the prior system?

Third, the ubiquitous nature of deregulation tells against a single exogenous shock changing a regulatory equilibrium. What single disturbance could affect airlines, telephones, trucking, and natural gas?

Third, the primary beneficiary of regulation may have been—just as the Stiger-Becker reformers claimed, in their role as advocates of how things *should* be (rather than as analysts of how they *are*)—the most unorganized group of all: consumers. In his summary of deregulation efforts, Clifford Winston (1998) suggests that this was indeed the case, due to lower prices, increased competition, and more rapid technological innovation. The other primary beneficiaries were often new firms, such as Southwest Airlines, that did not exist before deregulation. How do such firms, along with unorganized consumers, fit into a Stigler-Becker interest-group-dominated world?

Finally, in many episodes of deregulation, it was difficult to envision the ultimate benefits, let alone the beneficiaries. Railroad deregulation in Great Britain is a case in point, as economists were unsure whether it is possible to maintain a unified rail network while privatizing many of its components. In the United States, airline deregulation opened up the possibility of more frequent travel for both business and recreational purposes in high-density corridors, but sharply reduced service in rural areas. Moreover, the airlines' differential pricing policies for seats on the same flight—what the airlines term "yield management"—have allowed

the airlines to saddle business travelers with relatively high fares at the same time as they are forced to travel under increasingly congested conditions.

One proponent of the Stigler-Becker theory has taken seriously the challenge of explaining deregulation. Sam Peltzman (1989) argued that technological changes reduced the economic rents that were available in regulated industries, thereby lowering the incentives for continued regulation. Peltzman attempted to apply this argument to specific episodes of deregulation. Peltzman's energetic efforts, however, left many of his colleagues "disappointed that a 'meta-theory' has not emerged which can adequately explain when, and in what sectors, regulation is put in place and when and where it is dismantled" (58).

By raising challenges to a Stigler-Becker account of deregulation, I do not wish to preclude its applicability. It may be true that in some cases, the progressive inefficiencies of existing regulations led to profound dissatisfaction on the part of powerful interests. A case in point may be electric utility deregulation in California. Driven by a desire to pursue alternative energy sources, regulators mandated that utilities purchase very expensive alternative power from a variety of politically fashionable sources, such as windmills and geothermal plants. They also made arrangements with very large utilities that allowed them to shift some of the risks of their nuclear plants to shareholders, but at the expense of higher costs to ratepayers. Business interests began to view the resulting high cost of electric power as a serious impediment to economic development. The California Manufacturing Association and other business interests began to champion (incomplete) deregulation and began working with the legislature to change the existing structure. On the other hand, the chaos that developed in the electricity market in California in 2000 and 2001 is also testimony to the unintended consequences of deregulation. It appears now that large businesses in California will pay much more for electricity in the deregulated world than they ever would under old-style regulation.

Perhaps there are similar episodes of progressive and cumulative inefficiencies in other industries that will eventually motivate well-organized interests to push for deregulation. Nonetheless, until a case is made that an extended Stigler-Becker approach can account for deregulation, we are entitled to conclude that deregulation must be viewed as a movement, not simply as a series of isolated episodes—and a movement whose recommendations were motivated and implemented by government actors who were convinced of the validity of certain ideas,

not by interests that (somehow) "captured" the government in pursuit of their narrow ends.

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