

**PRESIDENTIAL CONTROL AND REGULATORY  
COMMITMENT OF LONG RUN: THE ROLE OF THE  
REGULATORY IMPACT ANALYSIS**

By Alexandre Gheventer

Advisor: Ernie Englander

---

## Table of Contents

<b>Introduction</b>	<b>3</b>
<b>I. RIA'S Implementation In Brazil: Current Position</b>	<b>5</b>
a. The Brazilian Regulatory Reform	5
b. RIA's Implementation Project in Brazil	8
<b>II. What is Regulatory Impact Analysis (RIA)?</b>	<b>10</b>
<b>III. Theories of Regulation</b>	<b>16</b>
a. Normative Theory of Regulation	16
b. Capture Theory	18
c. Economic Theory of Regulation	19
<b>IV. Regulatory Commitment or Regulatory Exploitation: a Decision Model</b>	<b>23</b>
<b>V. The Presidential Control on Regulatory Policy</b>	<b>30</b>
<b>VI. OIRA Performance in Clinton and Bush Administrations</b>	<b>36</b>
<b>Conclusions</b>	<b>41</b>
<b>References</b>	<b>43</b>

---

## INTRODUCTION

One of the main subjects in political economy, especially in the area of the regulation, is the question of “who regulates the regulator.” A possibility pointed out by the literature is the political control of the agency through procedural instruments. Amongst these instruments we can emphasize the introduction of “regulatory impact analysis” (RIA). The RIA’s introduction and institutionalization is in the political agenda of the Brazilian government and is part of a set of proposals with the objective to improve the governmental capacity in regulation matters.

This paper has the purpose a) to study how the RIA is institutionalized in USA - carried through by *Office of Information and Regulatory Affairs (OIRA)* in *Office of Management and Budget* -, b) if there are elements that could support the affirmation of that the process of OIRA’s analysis has been neutral in the time or if it tends to benefit the present administration and, c) in the light of the American experience and considering our specific institutional design, which of the possible inferences about the consequences, positive or negative, could apply to RIA’s implementation in Brazil.

The introduction of the RIA has been sustained on the traditional premise that the main governmental objective is to promote social welfare. Under this premise, regulation will always try to guarantee the optimal allocation of resources in order to maximize benefits and minimize costs, whether administrative costs or costs related to the society’s adherence to the regulation. Behind the idea of RIA’s implementation there is the recognition of the existence of asymmetrical information between the agency and the politician (or the legislator), which can result in adverse selection and *moral hazard* problems. Regardless, the attainment of the best regulatory policy is only a technical issue. Normally this type of approach tends to ignore, or undervalue, the role of the economic and political institutions.

In opposition to the traditional view of the role of regulation, there is the economic theory of regulation (TR), based on the hypothesis of rational choice in the public world. For TR, regulation results from demands of diverse groups of interests for

governmental intervention. The nature of the actor who moves in the politics is the same one of the actor who acts in the market. The regulator/politician will be rational if he chooses not the most efficient regulation (lesser dead-weight loss), but the one that will maximize his private interests (in the terms of Stigler (1971), votes and money of electoral campaign). In this direction, sometimes, creating market imperfections can generate electoral benefits, despite the eventual losses of social welfare. Some authors, for example, Becker (1983), argue it is possible to reconcile the hypothesis of rational choice with the correction of market imperfections. Even so, if this happens, it will be because of rational calculation and not because the politician or bureaucrat is benevolent or Kantian.<sup>1</sup>

Therefore, considering the hypothesis of *rational choice*, the agency responsible for the RIA theoretically will have incentives to promote a biased evaluation of the costs and benefits of regulation for an administration pro or against regulation. It does not mean that the RIA cannot generate good governance and increase the quality of the regulation, given the incentives from the institutional structure. However, as a result of a degree of reasonable subjectivity in the evaluation of the costs and benefits of regulatory proposals, a low degree of transparency and imperfections in the mechanisms of check-and-balances between the Executive branch and the other powers can generate a socially inefficient regulatory design.

The decision to act in short run (regulatory exploration) or in the long run (regulatory commitment) results from a calculation derived from the comparison between the benefits reached with the regulatory commitment and the costs generated for the disutility of the Executive in giving up its preferences for the maintenance of this commitment. The introduction of the RIA can exert the influence to adapt the preferences of the agency to the political agenda of the Executive, without risks to the regulatory commitment and to the efficiency of regulation, since the institutional design considers the incentives foreseen by TR.

---

<sup>1</sup> There is some academic discussion about the rationality issue. In daily situations, many individuals take decisions under considerations of moral order that contradicts its personal preferences. The point is not to evidence the existence of benevolent and kantian people, but to explain the results observed in the public world.

RIA influences the behavior of the agency since it will take in consideration the probability to have the proposal reviewed or, in last case, refused. In this way, the agency will be able to formulate strategies of presentation of proposals that also consider the preferences of the Executive, and thus minimizing the number of vetoes or reviews, without perceiving any arbitrariness, at least in an explicit form. Consequently, the preferences of the agency can be adapted in favor of the Executive, without necessarily losing of regulatory credibility. However, if the Government decides to be more or less rigid in relation to the analysis of the rule without transparency or if manipulation occurs in the formal procedure of the process of regulatory analysis, the introduction of the RIA will not necessarily be beneficial.

Section I presents the current position about RIA's implementation in Brazil. Section II introduces a definition for RIA, including the difficulties usually related to implementation. A brief description of main regulation theories, especially, the normative theory, the capture theory and economic theory of regulation, are described in Section III. Section IV provides a model to explain the Executive decision of whether to preserve the regulatory commitment of long run and suggests that RIA, on some level, can affect the Executive choice. Section V presents a brief overview about the historical development of presidential monitoring on USA regulatory policies, including the formal process of regulatory review. Some considerations about OIRA's performance during the Clinton and Bush Administrations are developed in Section VI. Finally, the last section presents the conclusions of this paper.

## **I. RIA'S IMPLEMENTATION IN BRAZIL: CURRENT POSITION**

### **a. The Brazilian Regulatory Reform**

The majority of the regulatory agencies were created in the second half of the 90's decade, during the Fernando Henrique Cardoso Government. Before this period, no one could say that regulation in Brazil existed, at least in the classic sense of this word, since the areas considered typical for the regulation were occupied by state-owned firms. It is important to emphasize that, although the idea of independent regulatory agencies may have found inspiration in the North American experience, we can't lose sight of the fact that the implementation of these agencies in Brazil occurred under the

context of the privatizations and the economic opening. The agencies' autonomy was the strategy adopted by the Brazilian State to generate credibility, which is a specific problem of the Latin American institutions. Getting credibility means indicating to the market that the rules are stable and, therefore, firms can have legal confidence on property rights, which stimulates investments.

Gaining credibility is a governmental objective in the context of global economic environment, as it was in the past, which stimulated the process of substituting importations. On the other hand, Melo (2001) wrote that delegating powers to the bureaucracy implies increasing democratic deficit in contemporary democracies. The dilemma is particularly strong in Latin America. It is verified as a preponderate Executive in relation to the other powers, which can imply, as Boschi and Lima observed (2002), not only the relative loss of the autonomy of the agency, with consequent damages of the regulatory credibility, but also the weakness of the democracy. The previous institutional legacy cannot leave aside, especially an Executive with ample intervention powers and a Legislative with a low degree of control on the results (*accountability*) of the economic policy.

It must also be observed that in Brazil, an agency from the center of the federal government systematically dedicated to the supervision, promotion, coordination and monitoring of the quality of the regulatory activity does not exist. The result is that the process of the institutionalization of the regulation in Brazil, according to Pó & Abrúcio (2006), "was strongly led by the conceptions of the ministries and the bureaucracy of each sector, and not by some general directive line, with impact on the format and the functioning of the established agencies."<sup>2</sup>

The new Government inaugurated in 2003 understood that the Brazilian model of regulation should have to suffer adjustments. The extreme autonomy of the regulatory agencies, which resulted in the lack of social control and accountability, was one of the main critiques raised in relation to the current regulatory framework. On March 2003, it was created an inter-ministerial working group to analyze, discuss the organization and propose measures to improve the institutional model of the federal regulatory agencies.

---

<sup>2</sup> Pag. 683

In 2004, the Federal Government sent the Project of Law nº 3337, of 2004 (PL 3337), to the National Congress. The PL 3337 has the following objectives: a) to attribute to the Ministries the competence to formulate the sector policies and to grant public services; b) to enlarge the social control and accountability mechanisms , by making the process of public consultation and the presentation of annual reports to the Ministry sector and the Congress necessary; c) to introduce the management contract that subjects the budgetary resources to a condition of fulfilling goals of administrative performance and monitoring; d) to make the existence of an independent audit in each agency necessary; and e) to improve the operational interaction between the regulatory agencies and the competition defense (antitrust) agencies. It is important to observe that the PL 3337 maintains the formal autonomy of the agencies. The current system of fixed and non-coincidental mandates of the regulatory authorities in relation to the mandate of the President of the Republic is preserved in the proposal

It is also important to mention the Project of Amendment to the Constitution nº 81 of 2003, that intends to fix constitutional principles for the regulatory activity, such as competition defense and consumer rights, accountability, impersonality, transparency and publicity, functional, decisional, administrative and financial autonomy, notorious capacity technique and untouched reputation to exercise direction functions and stable and foreseeable rules.

By initiative of the Casa Civil of the Presidency of the Republic, in joint with the Ministry of Finance and Ministry of the Planning, Budget and Management, and with the support of the Inter-American Bank of the Development - BID, the Program of Institutional Capacity Strengthening of Management in Regulation - PRO-REG (Decree nº 6.062, of 16 of March of 2007) was created, with the purpose of contributing for improvement of the regulatory system, of the coordination between institutions that participate in the regulatory process in the scope of the Federal Government, in the mechanisms of accountability as well participation and monitoring by civil society and of the quality of regulation. The creation and implementation of a body that will be responsible by coordination, monitoring and analysis of regulatory issues, is foreseen in the scope of the executive power.

Finally, in the same year, the Brazilian Government requested to the OCDE the accomplishment of a process of peer review on the Brazilian regulatory system. The peer review process considered four regulatory agencies: The National Agency for Electric Power (ANEEL), the National Agency for Supplementary Health Services (ANS), The National Telecommunications Agency (ANATEL) and The National Agency for Road Transportation (ANTT). Among the recommendations presented by OCDE, two of them were particularly emphasized: the introduction of the regulatory impact analysis and the creation of a unit of supervision of the regulatory quality in the center of the government.

#### b. RIA's Implementation Project in Brazil

According to the cooperation contract signed with Inter-American Bank of Development, the completion of studies in order to implement a central unit of coordination is a prior condition of PRO-REG obtaining technical and financial support. This central unit of coordination would have the following functions:

- a) Develop and implement a government net on regulatory quality, consisting of public servants of the ministries, agencies and academic representatives. This net will be responsible to manage a database with information about regulatory questions;
- b) Develop a strategy to introduce the regulatory impact analysis as a tool to improve the quality of the regulation;
- c) Develop tools of management to build consensus and agreements around strategic objectives of sector policies, supporting the action of the regulatory agencies and guaranteeing its financial autonomy; and
- d) Provide technical assistance to implement these tools and training to the public and private sector, academic community and consumers.

The Terms of Reference (TOR) with BID resources were signed in 2008. These TORs have the objective to accomplish studies to elaborate proposals of structuring a central unit to coordinate, monitor and evaluate regulatory subjects, as well as drawing a



strategy of RIA's implementation and institutionalization. According OECD's best practices, how this strategy should be designed?

First of all, legitimacy and political support is important as a short/medium run strategy. Regulatory policy needs to be supported at the highest political level to overlap the inertia and opposition. Without a strong political commitment to better quality regulation, the RIA's implementation probably will fail. There are also other important elements to be considered:

- Balance the advantages and disadvantages of choosing between a centralized and decentralized model - that implies sharing responsibilities and mechanisms of consultations between different regulatory institutions with the objective of obtaining consensus;
- Convert the RIA's unit into an regulatory agency with higher degree of autonomy in the long run, which means, for example, the creation of mandates and formal procedures of nomination;
- Build technical qualification, which includes training programs. But this training should not be confined to the governmental authorities. For example, public consultations are the usual channel of civil society and private sector to participate in the regulatory process. So, supplying technical qualification to the society certainly will improve the quality of these consultations.
- Design an adequate human resources policy in order to attract high quality professionals;
- Formulate guidelines to support the regulatory decision-making process;
- Select project-pilot with adequate technical criteria;

- Define RIA's scope, considering the resources' scarcity. Some countries require RIA of main laws and policies. Other countries have a more restricted scope, only reaching subordinated regulation or in particular areas;
- Design strategies to collect data with minimal cost and considering the time restrictions required by the regulatory review;
- Integrate RIA to the process of policies formulation, which means conducting RIA in satisfactory time, as well as monitoring the implementation of the new regulation;
- Give publicity to the RIA's results - not only of the regulatory proposal, but all the process, including the alternatives not considered;
- Involve the public actively by consultation procedures. An efficient process of consultations is important to guarantee the higher possible quality of the information with the lesser possible cost, including time cost; and
- Apply RIA as an instrument of evaluation of performance of regulations already established.

However, RIA's effective implementation has some obstacles, not only in the technical sense, but related to the country's institutional context too. The next section has the objective presenting these difficulties, as well describes a more precise definition of RIA.

## **II. WHAT IS REGULATORY IMPACT ANALYSIS (RIA)?**

Before we define what RIA is, it is necessarily a small definition of "regulation". Regulation is nothing more than the governmental efforts of limiting the rank of choices

of the individuals<sup>3</sup>. It consists in an activity with the objective to direct, correct or in some way to modify the natural and spontaneous results of the market. To regulate, therefore, means to create norms in order to intervene indirectly in the economy.

The arise of the regulation in the last few decades emerged with the transition from an interventionist state, based in the direct control over the economy, especially, over the public services, to the regulating state, based on other type of control, of indirect form, by means of the regulatory norm<sup>4</sup>. With the increasing importance of regulation as a public policy instrument, its scope and direction tends to generate significant allocative and redistributive effects, which leaves the regulation susceptible to the political disputes. In this context, the traditional budgetary process loses importance and the attention of the main actors tends to focus on the regulatory process.

The more usual institutional design for the conduction of the regulatory process is the creation of specialized and independent agencies. Two problems arise from that design. In first place, the Executive branch may have political and ideological preferences that are divergent from the decisions made by the agency. This can be interpreted as the cost that the Executive conscientiously desires to incur to assure the regulatory credibility (see Section 4). Second, because of the information asymmetry between the agency and the politicians, the authorities of the agency have the incentive to maximize their own prestige – in order to obtain better positions - or income – proposing regulatory norms that will benefit groups of interest. In economic literature, this subject is known as the principal-agent problem, which will be discussed with more details in the following section.

RIA appears under this context. Normative literature about RIA (as for example, the OECD guidelines) emphasizes its role in terms of increase of the quality of the regulation. Therefore, the introduction of RIA can discipline regulators in order to formulate an efficient and focused regulation, minimizing the economic and social consequences derived from the principal-agent problem.

According to the OECD, RIA can be described as:

---

<sup>3</sup> Meier (1985)

<sup>4</sup> Majone (1999)

“an information-based analytical approach you assess probable costs, consequences, and side effects of planned policy instruments (laws, regulations, etc.). It can also be used you evaluate the real costs and consequences of policy instruments to after they have been implemented.”<sup>5</sup>

Assuming that the State has the objective to maximize the social welfare, its intention will be:

“to explain the objectives of the proposal, the risks you be addressed and the options will be delivering the objectives. It should make transparent the expected costs and benefits of the options will be the different bodies involved, such them to other parts of Government and small businesses, and how compliance with regulatory options would be secured and enforced”.<sup>6</sup>

RIA does not replace decisions about the regulatory policy, but allows that these decisions can be taken with higher degree of information about costs, risks and possible alternatives. RIA, therefore, aims to become the regulatory decision more efficient and effective, that is, to reach the objectives planned (effectiveness) with lesser cost (efficiency). In accordance with guidelines about this matter<sup>7</sup>, RIA is constituted by several elements (or steps).

In first place, it is necessary to examine if the problem is correctly defined, as well as the objectives of the regulation proposed. In second place, it must be verified if these objectives will be reached by the most efficient way. All the possible options, regulatory or not, that could satisfy the objectives of the proposal, should be identified. It is important to evaluate if the regulatory proposal would be the best alternative to solve the problem and if, therefore, the government action can be justified in a reasonable basis. In this stage, the impact of the chosen option must be identified and quantified, including benefits, costs and distributive effect.

---

<sup>5</sup> SIGMA (2001)

<sup>6</sup> NAO (2002)

<sup>7</sup> See, for example, OECD (2007)

The analysis must consider if the new regulation can easily be implemented with high adhesion degree. If the adhesion is hard to accomplish, the direct costs of the government to enforce the new norm and the cost of the private sector and the individuals to adapt under this norm will increase. Therefore, the efficiency and effectiveness of different strategies of adhesion of the regulatory proposal must be evaluated.

RIA can be used not only to evaluate the introduction of a new regulation, but also to the accompaniment and reevaluation of regulatory norms already existing. Therefore, monitoring mechanisms must be developed to evaluate the performance of the action proposal and to improve the regulation.

The formulation of public consultations in order to stimulate the participation of all the relevant actors in the regulatory process is also considered a fundamental feature of RIA. In first place, it supplies valuable information about costs and benefits of alternatives and its effectiveness. Besides that, it can contribute to build consensus and, therefore, to minimize the adhesion cost. Finally, it increases the transparency of the decision process, which is an important democratic value to be considered.

It is important to point out that the incorrect use of the consultation can produce distortions in the evaluation of the impact of the new regulation and generate sub-optimal results. Firms tend to be better organized and usually participate in the consultations with more frequency than the consumers. Therefore, public consultations create a risk of a pro-industry bias. Interested third parties can overestimate its costs. Opinions on the proposal can be supported by wrong hypotheses or insufficient information. Finally, the formulation of the consultation delays the implementation of the new regulation, which is also, many times, a relevant cost.

A problem that makes the task of impact analysis especially hard is how to quantify all the costs and benefits associated with the regulatory proposal. Obtaining complete information tends to be excessively costly and normally is impracticable. Moreover, agreement cannot exist about the values of the indirect effect of costs and benefits caused by the introduction of some regulation (as the effect on the competition or on the

job level). Other types of benefits are impossible to quantify in monetary terms (quality of life, for example).

There are other methodological obstacles. Just using nominal market prices to calculate costs and benefits that will occur in the long run clearly is not an appropriate method, considering the inflation and the existence of opportunity costs. These variables have a lower present value, what demands some discounting rate. Of course, this is not a trivial task. The usual method is the liquid present value (LPV), which brings the expected benefits in the future to the present through the application of a discounting rate.

The first difficulty is to define the discounting rate. An option could be the interest rate of the public sector debt. However, this option maybe means to discount the benefits to an excessively high rate, undervaluing the social positive impact of the new regulation. On the other hand, a excessively low discounting rate is not desirable either, since it can result in the inefficient management of the public resources.

Another problem is choosing the latency period of the benefits, that is, the time gap between the introduction of the regulation and when its effects become perceivable (for example, benefits with reduction of cancer risk resulting from measures of environment protection or working safeguards). The choice of the latency period has a strong impact on the value of the benefits of the new regulation.

Therefore, the cost-benefit analysis is frequently associated with some degree of uncertainty on its results. Most part of the analysis tends to be qualitative and depends on hypotheses on the importance of costs and benefits that are not easy to be quantified and/or monetized.

Under this approach, the *first best* solution will not be reached only because of the uncertainties derived from informational problems. Because of the principal-agent problem, the regulator/politician has to choose a regulation model under these informational restrictions in order to reach a sub-optimal solution (*second best*). Anyway, it remains the premise of that the regulator/politician always acts in accordance with the public interest. It is assumed that the political actor, endowed with

better information after RIA, will implement the most efficient policy, even under some degree of uncertainty in the environment (but less than before the analysis).

As we saw before, the OECD identifies a list of best practices, to introduce RIA: 1) maximise political commitment to RIA; 2) allocate responsibilities for RIA programme elements carefully; 3) train the regulators; 4) use a consistent but flexible analytical method; 5) develop and implement data collection strategies; 6) target RIA efforts; 7) integrate RIA with the policy-making process, beginning as early as possible; 8) communicate the results; 9) involve the public extensively; and 10) apply RIA to existing as well as new regulation.

But what about the institutional context where these practices will be introduced? As remembers Radaelli<sup>8</sup>, it is important to have in mind the institutional circumstances where the regulatory reforms are implemented : “(...) in all process of administrative innovation and regulatory reform there are elements that cannot be transferred from one country to another without taking into account institutional legacies, state traditions, and the dominant legal culture”. Abrupt institutional discontinuities rarely exist, unless in extreme situations, as revolutions. In this sense, as North observes<sup>9</sup>, decisions on the present depend partially of decisions taken in the past (*path dependence*). The institutional structure was built inside of a set of restrictions that, in this turn, bias future choices.

This means to say that we cannot transfer a listing of best practices from one country to another under distinct institutional context for mere emulation. The formal introduction of good practices associates to RIA can legitimize changes in the property rights caused by the introduction of some new regulatory rule and speeding up the process of institutional change. But, in the same way, it can also legitimize the decision to stop or delay its introduction, resulting in inefficiency. In fact, “they may be used in context very different from the one of the country of origin, with the aim you avoid radical reform by injecting the bit of ‘good practices’ into otherwise bad systems. The result can be delay in the process of change.”<sup>10</sup>

---

<sup>8</sup> Radaelli (2002)

<sup>9</sup> North (1990)

<sup>10</sup> Radaelli (2002), pag. 14

The objective of this paper is not to make any comparative analysis about the international experiences of introduction of RIA, but rather to present the importance of considering the incentives when introduced in some specific institutional context. These incentives derive from the hypothesis of rational behavior of the political actor and the existence of previous institutional legacy. The introduction of a new rule is always a legislative action and, therefore, depends on the process of bargain carried through between the Executive branch and other key actors. Although the Executive is an active player with power to manipulate the institutional environment, it will not act as a benevolent dictator, but rather as a self-interested actor. However, this capacity is not infinite. It is limited by the restrictions derived from its bargaining power with other actors, as voters, Congress and lobbies.

RIA is an instrument to control the regulatory process - although supported by the so-called “best practices”, which gives legitimacy before the market. It aims to lead the agency to the preferences of the Executive. Assuming the rational hypothesis, the Executive will try to pursue the objective to obtain the benefits derived from the regulatory credibility with minimal cost, understanding “cost” as the degree of divergence between its preferences and the course of the regulatory process.

### **III. THEORIES OF REGULATION**

Basically, the economic literature presents three hypotheses for the existence of the regulation. First, the most traditional one is known as theory of the public interest or normative theory of the regulation (NTR). In accordance with the NTR, regulation arises in industries that have market imperfections. The purpose of regulation would be to guarantee the optimal allocation of resources in situations where the market would not be capable of making it. Inconsistencies between many empirical situations and the NTR resulted in the formulation of another hypothesis, known as capture theory (CT). In this case, as the agency is captured by the industry, the objective of the regulation would be to maximize the profits of the regulated industry and not to promote the social welfare. Finally, the economic theory of the regulation (TR) looks to make compatible the hypotheses of the NTR and the CT. In the case of TR, although the regulation is not



strongly associated with market imperfections (as in the case of the NTR), the results are not necessarily pro-industry (as always happens under the CT hypothesis).

a. Normative Theory of Regulation

According to NTR, the existence of market imperfections justifies the *rationale* of the regulation. The State - which assumes the figure known as *benevolent dictator* - interferes in the market with the intention to assure that the search for the private interest does not come in conflict with social welfare. As Train observes (1995), the term *hand-visible*, in this case, would be rather appropriate: the regulator induces the firm to produce the socially desired result. There are three very common circumstances that don't make the free markets work in a satisfactory way: i) the existence of natural monopolies; ii) externalities; and iii) market power.

We say that a market is a natural monopoly when, in order to produce any good or service in a socially optimal amount, the costs of the industry are minimized by the existence of only one firm. The justification for the governmental intervention in situations where natural monopolies occur is sufficiently clear. When only one firm produces, there is productive efficiency; therefore the value of the resources used for the production of the good is minimized. However, when maximizing profit, the monopolist fixes its price above the marginal cost, implying allocative inefficiency. A configuration of market with many competitors could result in the reduction of the price; however the result would be wasting resources. The market, in this case, is incapable of creating a satisfactory solution.

One second category of market imperfection is known as externality. This happens when the action of an economic agent (consumers or firms) affects the utility of another one. The agent considers only costs and private benefits of its action, and not social costs and benefits. In this case, when negative (positive) externalities occur, the imposition of tax (subsidy) leads to economically better results.

Another imperfection of the market is the economic power of one or more firms in industries where competition would be desirable – therefore, we are not talking about natural monopolies. The economic concentration is very common in modern economies.

Some degree of economic concentration can help the innovation process<sup>11</sup>. However, it can create conditions for several anticompetitive conducts - cartel, predatory pricing, retail price maintenance, etc. Moreover, although the perfect competition is impossible in modern economies and even undesirable (from the point of view of internal efficiency), the rivalry is essential for the acceleration of the innovative process.<sup>12</sup> The more typical way of intervention, in this case, is the antitrust regulation. The objective of the antitrust policy, from NTR point of view, would be to create and keep a competition market environment - not only by rules of behavior but also by the control of merger and acquisitions.

According to NTR, regulation is a reaction derived from the public demand for correction of market failures. Nevertheless, one of the most important criticisms against the NTR is its inconsistency with reality. It does not have strong empirical correlation between regulation and markets where these imperfections occur<sup>13</sup>. In the second place, as observe Viscusi, Vernon & Harrington (2000), the regulation occurs by legislative action and is mediated by the regulatory agency. The NTR does not explain why politicians and regulators would be induced to correct market imperfections. Many times, the results of the regulation don't promote the public interest, but the interests of the regulated industry.

#### b. Capture Theory

The capture theory (CT), in contrast with the NTR, states that regulation is designed to support the industry. There is a tendency to capture legislators and/or regulatory agencies. The use of illegal ways of cooptation (as bribe or promises of key-positions in the industry) is not a necessary condition for regulatory capture. The problem of asymmetry of information is that the regulator becomes dependent on the firm since the beginning of the regulation process. Besides that, industrial lobbies tend to be more organized and have more resources than pro-consumer organizations.

---

<sup>11</sup> For Schumpeter, highest innovative effort demands more concentrated structures of market. See Schumpeter (1961).

<sup>12</sup> See, for example, Scherer & Ross (1990)

<sup>13</sup> For example, services of taxi drivers or even agriculture are competitive markets and still regulated. See Posner (1974).

After having studied industries regulated by several agencies - as the Interstate Commerce Commission (ICC) and the Civilian Aeronautic Board' s (CAB), among others - Jordan (1972) concludes that regulation is pro-industry, that is, it tends to protect the interests of producers in detriment of consumers. Regulation produced little or no effect in natural monopolies, as electric energy: prices remained stable and above marginal costs, practices of price discrimination still persisted and profit rates were fixed higher than the returns expected on competition level. Stigler & Friedland (1962), after analyzing the behavior of the prices of electric energy between 1912 and 1937, came to the same conclusion: the effect of the regulation had been insignificant. To these authors, the regulation was essential to raise the market power of firms already established in competitive industries. The result was higher prices, dissemination of discriminatory practices, cartelization and creation of entry barriers against potential competitors.

The main criticism of the TC is that it does not explain why only the industry can control regulation. Other interests groups also affected, as consumers and unions, can influence the regulation. In the second place, regulation has resulted in lesser profits in many industries - for example, oil and natural gas, environment regulation and security in the work. In addition, it does not explain why, in specific situations, the same industry is regulated before and deregulated later.<sup>14</sup>

### c. Economic Theory of Regulation

In the last decades, literature on regulation has paid attention to the fact that the state intervenes not only to correct market imperfections, searching to assure the best allocation of resources, but also to promote private interests and maximize political support. This line of research is based on the postulate of the rational choice, where politicians and bureaucrats maximize its private welfare. However, these players are submitted on several injunctions, such as problems of information and costs of transaction and, in particular, institutions.

---

<sup>14</sup> See Viscusi, Vernon & Harrington (2000)

The hypothesis of benevolent dictatorship existing in the NTR is relaxed under the TR. It is assumed the existence of more than one principal (the Congress, voters, firms, courts, etc, implying in the relaxation of dictatorship hypothesis) and that governments and bureaucracies also pursue their own interests (relaxation of the hypothesis of benevolence).

Although many results of TR are similar to the TC, this last one is based only on the hypothesis that the regulation is pro-industry. It does not explain why the regulation occurs, why specific groups benefit and not others and the reasons for which, many times, small firms receive special benefits. Stigler (1971), Peltzman (1976), Posner (1974), Wilson (1974), Becker (1983), among others, try to demonstrate that the regulation results from the competition between pressure groups (including voters) for political influence. The result of the regulation depends on three questions: a) who wins and who loses; b) the weight of the costs and benefits for each group; c) the size of the involved groups; as Olson (1968) affirms, the greater the size of the group, the greater the problems of free-riding. Different from the simplistic version of the theory of the capture, the winning group does not gain everything; competition between pressure groups exists. The politician takes in to consideration the intensity of support/opposition of the groups and selects the optimal group size to be benefited or taxed.

According to TR, regulation is the result of the demands of diverse groups of interests for governmental intervention. However, in general politicians are not responsible for the implementation of the policies and therefore divergences can occur between the policies considered optimal (that is, policies that favor the groups of interests) and the effective policies. In this way, the theory of the regulation, based on rational choice, has been expanded to include the principal-agent theory.

Much of the analysis on regulation involves principal-agent problems: A (the principal) has objectives that can only be reached by B (the agent), either because B is responsible for the decisions delegated by A, either because B has better information, or both. Considering that B does not necessarily have the same preferences as A, which institutional mechanisms would allow higher control of A over B and, thus, guarantee the desired results?

The non-alignment of objectives between principal and agent comes from asymmetrical information problems. In the first place, problems of adverse selection can appear when the principal cannot observe the type or quality of the characteristics of the agent (hidden information). This question was treated by Akerlof (1970)<sup>15</sup> in an article on the market of “lemons” (American terminology for poor quality cars). Problems of *moral hazard* can also occur when the principal cannot observe the level of effort of the agent (hidden action). A typical example is the insurance market where, many times, the insurer is not capable to observe the level of effort of the insured part in “taking care”, which tends to be lesser when the individual acquires insurance.

Economic literature about the principal-agent problem focuses its attention on the relations between regulator (agency) and regulated (firm). However, the problems related with the requirement of delegation and, as a result, the need of the principal to control the actions of the agent are not restricted to the relations between regulatory agencies and firms. Voters and politicians also have principal-agent problems. Each of these groups pursues its own interests, which are not necessarily in accordance with the public interest.

In the model Stigler/Peltzman, politicians respond to the pressures exerted by groups of interests for reasons sufficiently clear: their political survival depends on votes and economic support. If the politician does not present satisfactory responses to those demands he will be replaced by others politicians. However politicians are usually obliged to delegate the responsibility of the decisions to the bureaucracy. Delegation implies that bureaucrats will have more information on the regulation than the politicians. In addition, politicians' and bureaucrats' objectives are normally divergent because it is not possible to have direct connection between voter and bureaucrat. For example, the desire to maximize prestige to obtain better positions in the Executive branch or good jobs in the private sector can be placed in the top of the preference order of the bureaucrat. The principal-agent problem is characterized by a) the actions of the bureaucrat, which are not intrinsically observable by the politician and b) different same preferences about the regulatory policy direction.

---

<sup>15</sup> As the buyer of a used car cannot guess the quality of the good, he has to make inferences about the average quality from the prices. The final result is the exit of the good cars owners and the decrease of the quality in the market of used cars.

From this insight, two lines of analysis have been developed. The first, known as “bureaucracy approach”, is more related with the traditional capture theories: the principal-agent problems are so severe that the bureaucracy can act independently from the desires of the Congress or the Executive.<sup>16</sup> Another approach, known as “Congressional Control”, considers that the instruments of the Congress have enough power to control the regulators. For example, Weingast & Moran (1983), when analyzing the behavior of *Federal Trade Commission* (FTC) in the end of 70’s, they attempted to demonstrate that political institutions are built with the purpose to influence the policies formulated by regulatory agencies. Using indexes known as *American for Democratic Action* (ADA) as *proxy* of the preferences of the legislators, the authors demonstrated that the changes in the policy led to a more passive FTC caused by the reversion of the preferences of the specific Senate commission (before pro-consumer).

Spiller (1990) tries to demonstrate that the two approaches deal with particular cases of a more general problem, where politicians and interest groups compete in order to influence the decisions of the regulator. The author observes that regulators can pursue interests that are not convergent with the interests of the politicians in two ways: a) they can generate less effort than that which is desired by the Congress,<sup>17</sup> and b) interests groups not perfectly aligned with the interests of congressmen can offer compensations to the regulators to reduce the effort and, thus, divert the regulatory policy in their benefit. The competition between congressmen and industry for the services of the agency increases the price of these services, which reduces the Congress’ benefit. The Congress could create legal instruments to restrict the influence of the industry. However, as the competition between the two principals (Congress and industry) raises the demand curve of the services of the agent (regulator), the agent obtains higher incomes. On the other hand, congressmen responsible to appoint regulators can receive these incomes from the industry if they do not enlarge the regulatory control. For this reason the congressman always will balance the highest costs of the agent services (as a consequence of its competition with groups of interests) and the benefits derived from

---

<sup>16</sup> See Niskanen (1971)

<sup>17</sup> Being a cost, all effort already is, by itself, desutility (displeasure).

the creation of incomes. If the liquid benefit is positive, the congressman allows the industry to increase its influence on regulators. If negative, the congressman hinders *ex-ante* the industry's influence. The author concludes that, although the Congress has instruments – such as budgets - to discipline regulators, the degree of congressional control is not perfect. Thus, the hypothesis of the existence of principal-agent problem between Congress and regulators cannot be rejected.

The principal-agent problem created large impact on the economic theory of regulation because it introduced the institutional design in the analysis of the regulatory policies. How do institutions, responsible for organizing the rules to be followed by the bureaucracies, mitigate the problems resulting from the principal-agent problem in order to make compatible the objectives of the politician and the regulator? To understand this process and the results of the regulatory policy, it is necessary to unveil the mechanisms of the internal working of the bureaucracy and to explain its performance.

#### **IV. REGULATORY COMMITMENT OR REGULATORY EXPLOITATION: A DECISION MODEL**

The view of the regulatory design as a mechanism of creating credible commitments between government and private sector is not distinguished from the neo-institutionalism perspective of TR. Levy & Spiller (1996) directs attention to fact that privatizations and regulatory reforms do not always reach the expectations in reason of the country's social and political institutions - Executive, Legislative, Judiciary, informal norms of behavior public, the character of the conflict of interests in society, etc. In accordance with these authors, the capacity to attract private investments and to generate efficiency depends on the capacity of the country to restrict the arbitrary administrative action.

The choices about the regulatory regime and its structures of incentives, according to this perspective, should not omit the broader institutional environment, which determines the shape and the severity of the regulatory problems of each country and the specter of existing options to decide among them. The regulatory commitment corresponds to a kind of balance: some determined level of administrative discretion is

necessary to respond to technological changes, but it cannot be high enough to become the regulation vulnerable to governmental exploitation.

The credibility is reached by means of the recognition that the rules must be obeyed and cannot be modified in any arbitrary way. It is of course, the second best solution, as the Government cannot manage the policies in an uncertainty environment. On the other hand, it is important to note that the first best solution is always impossible not only because of the presumptions of individual rationality and consequent opportunism, but also the limitations of cognitive capacity.

Is it reasonable to assume that governments always desire to formulate commitments considered as credible, to stimulate private investments and productive efficiency? It would be true in assuming the hypothesis of the State as a benevolent dictator. The regulatory exploitation, as Guasch & Spiller observe (1999), will profit the government if the direct (loss of reputation and future investments) and indirect costs (derived from the overlap of administrative and judicial procedures and from disrespecting check-and-balances mechanisms) will be lower than the benefits in the short term (electoral gains).

Beyond the short term preferences related to the temptation of manipulating the regulation in order to obtain electoral benefits, governments also have ideological preferences. These preferences imply the arbitrary and discretionary use of regulatory framework.

In the strict economic point of view, ideology can have a positive impact on the electoral value of the politician in the same way that the perception of the consumer about the differentiated quality of some product increases its economic value. It is also reasonable to assume that the reputation based on moral and ideological values has material value in niches of the political market. Anyway, it cannot deny that politicians formulate preferences and have views about the world that are influenced by feelings of moral or ideological order.

The formulation of preferences based on ideology is not inconsistent with the rational postulate. Even when these preferences do not aim for the investment in the reputation



of the politician, it may be considered as a personal consumption. Kalt & Zupan (1990) define ideology as “(...) political actor’s personal definitions of the public interest, pursued as a consumption good that yields satisfactions in the form of moral sentiments.”<sup>18</sup> If the ideology is a consumer good, then ideological preferences are consistent with the models of rational choice and institutions – political actors obtain utility (personal satisfaction) in consuming ideology.

Evidently, there is also an opportunity cost related of consuming ideology, in our case, an occasional loss of credibility, if acting ideologically implies to bypass the institutions, and therefore, acts an arbitrary and discretionary way. For the market, minimize the uncertainty, basic element for the accomplishment of long run plans, is more important than the ideological trend of the Executive branch: “We would just like to get Congress to do something - regulate, deregulate, put on a tax - but let us know as soon as you can what it is so we can go out and make out plans.”<sup>19</sup>

I will assume that the decision to act in the short or long term is resulted from the comparison between the benefits achieved with the regulatory commitment and the cost created by the disutility of the Executive branch in giving up its preferences, either the electoral or ideological nature, in favor of the maintenance of this commitment.

The first determinant is the present value of the future electoral returns derived from the economic benefits of the regulatory commitment - job, investment, economic growth - assumed by Executive (VP) and depends on a discounting rate. A high present value (low discounting rate) means that the Executive has strong expectations of electoral gains if he keeps the regulatory commitment. In turn, a high discounting rate means increasing concern with the extraction of benefits in the short term. In this in case, it does not have an interest in keeping any regulatory commitment.

Another determinant is that the cost of the Executive does not adopt its ideological preferences for the maintenance of the regulatory commitment, that, in the absence of better name, I will call “ideological cost” (Co). It is the distance between the preference of the Executive and the preference of the regulatory agency. The higher the distance

---

<sup>18</sup> Kalt & Zupan (1990), p. 104.

<sup>19</sup> Meier (1985), pag. 275

between the two preferences, the greater the ideological cost, and therefore, the smaller the probability of adopting regulatory commitments.

In formal terms, the model would be:

$$VPL \geq \sum_{t=0}^n VP_t - \sum_{t=0}^n Co_t$$

Where

$$VP_t = \frac{VF_t}{(1+i)^t}$$

VPL is the liquid present value,  $VP_t$  it is the present value in the time  $t$ ,  $i$  it is the discounting rate,  $t$  is the number of years,  $VF_t$  is the future value in the time  $t$ ,  $n$  is the total period in number of years and  $Co_t$  is the ideological cost in the time  $t$ .

If VPL is higher than zero in the year  $t$ , the Executive will keep the regulatory commitment in that year because the present value in  $t$  is surpassing the ideological cost in the same year. The moment of disruption of the regulatory commitment ( $t^*$ ) will occur when the present value of its future benefits equalizes, in the margin, the ideological cost. Therefore,

$$t^* \Rightarrow VP_t = Co_t$$

What is the behavior of the ideological cost in the time? It is possible that in the long run a closer alignment between the preferences of the Executive and the preferences of the regulatory agency can occur. In view of the existence of the Executive control on nominations, the profile of the agency can be adjusted throughout the time. In this line, the ideological cost would tend to be decreasing. For simplification I will assume that the ideological cost is constant.

In the case of the behavior of the future value (and, therefore, the present value) of the electoral benefits derived from the regulatory commitment, even though the existence of

uncertain elements that can provoke the abrupt disruption of the commitment - external shocks, supply crises, etc -, I will assume is decreasing in time. The reason is that the regulated markets are dynamic and therefore, are vulnerable to technological and economic alterations that change the initial conditions under the regulatory commitment. Therefore, the more dynamic the regulated market will be, the economic benefits produced by the commitments achieved in period  $t_0$  tends to fall faster. We have then:

$$VF = a - xt$$

$$VP = (a - xt) \frac{1}{(1 + i)}$$

$$Co = b$$

$$t^* \Rightarrow (a - xt) \frac{1}{(1 + i)} = b$$

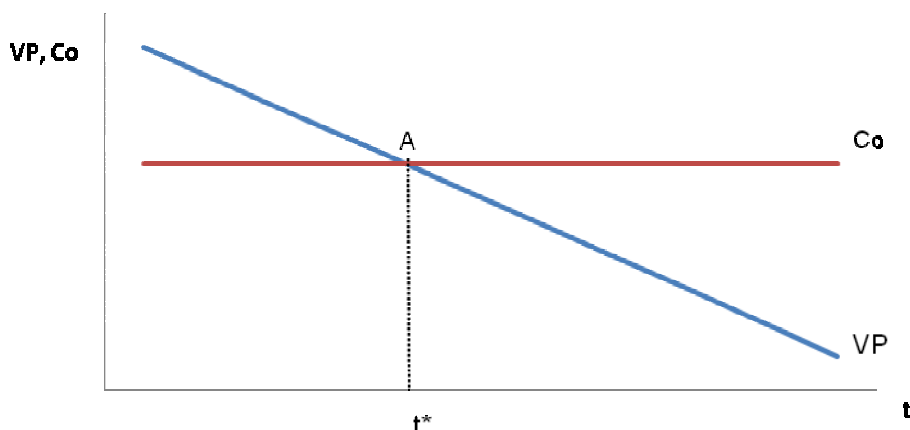
$$t^* = \frac{1}{x} (a - b(1 + i))$$

The equation above leads to the following conclusions:

- a) Higher  $x$ , that determines the slope of the present values curve, lesser will be  $t^*$ ;
- b) Higher  $a$  (the initial value of the present value), higher will be  $t^*$ ;
- c) Higher  $b$  (the ideological cost), lesser will be  $t^*$ ;
- d) Higher  $i$  (the discounting rate), lesser will be  $t^*$ .

The point A (see graph below) equals  $VP$  and  $Co$  and indicates  $t^*$ , from which it does not compensate for the Executive the maintenance of the regulatory commitment. Despite the regulatory agency adopting actions that do not correspond to the preferences of the Executive, which results in the cost  $Co$ , the regulatory commitment will not be broken before  $t^*$ , since the expectations of electoral gains are bigger.

**GRAPH 1**



From the side of the present value, I emphasize two important elements for the duration of the regulatory commitment. The first one is related to the degree of dynamism of the industry. Regulated industries where the technique changes are an important competitive instrument (telecommunications, for example), technological innovations constantly throwing down and creating barriers to the entry. Therefore, according to the model, the benefits expected by the Executive with the regulatory commitment originally agreed upon would tend to erode more quickly than in industries where the innovation does not exert so important role.

Another element would be the discounting rate chosen by the Executive in the regulated sector. What is considered by the Executive in order to determining this discounting rate? In the first place, there is a broad cause of historical nature, related to the growth of the regulating State, which provides lesser discounting rates. Another cause has relation with the political sensitivity of each sector. Politically sensible means that the Executive has more incentives to follows an opportunist and demagogic behavior, which generates a higher discounting rate. It is important to differentiate eventual alterations of general directives of the Government's sector policies from opportunist behaviors. Alterations of policy directives can be considered inopportune for the market, but not necessarily these changes are opportunistic.

Longer commitments can also be obtained with the reduction of the ideological cost, either by means of the alteration of the preferences of the Executive, either of the

agency. Severe changes in the economic - as supply shocks - and political environment - institutional crises, for example - can affect the preferences of the Executive. However, in situations of relative economic and political stability, the preferences of the Executive hardly will change in the short term.

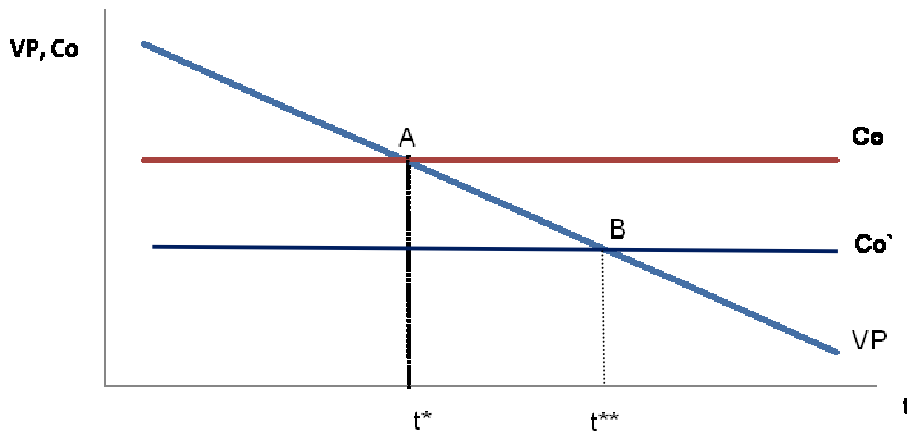
A subject frequently discussed by political analysts was the mitigation of the Workers Part speech - PT in the presidential election of 2002, when compared with previous elections, explicitly signaling a strong commitment with the market reforms and fiscal responsibility ("Letter to the Brazilian People") and chose as vice-president a member of the Liberal Party, that allowed the achievement of more credible regulatory commitments. On the other hand, it is important to observe that the PT's movement from left to the center did not occur in one day, but was a gradual process, which resulted in the developing of a partisan basis of mainly moderate trend. It was the existence of this basis that endorsed the Lula's Government to act in favor to the market, even as a strategic way, to minimize negative economic repercussions, but also to facilitate the process of negotiation and bargain of social politics inside Congress. Alterations of Executive preferences hardly will be able to occur in the short term.

Finally, the preferences of the agency can be modified in favor of the Executive, without necessarily any disregarding of rules or reduction of the autonomy degree. The usual instrument is the presidential control on the process of nominations. However, beyond the use of this instrument suffer from limitations (stable mandate of the authorities, non-coincident mandates, necessity of approval by the Senate, technical criteria to be filled, etc), remains the problem of the asymmetry information (principal-agent problem).

Another instrument, subject of this paper, is the use of the RIA as a way to monitor the character of the rules produced by the agency. The simple existence of the RIA is enough to modify the behavior of the agency, as it will take in consideration the probability to have the proposal reviewed or, in last analysis, refused. As a consequence, the ideological cost decreases and the period of the regulatory commitment can be lengthened to  $t^{**}$  (see graph below). The Government does not have to change the regulatory framework in order to achieve its own objectives.

Nevertheless, the regulatory stability is only an outcome of the Executive's economic behavior.

**GRAPH 2**



As we live in a world of incomplete information, the Executive always will have a reasonable space to allege insufficiency or distortion in the analyses of cost-benefit proceeded by the agencies. In this way, the agency will formulate strategies of presenting proposals that will also consider the preferences of the Executive and, thus, to minimize the number of vetoes or revisions. Even if the agency still decides to formulate a rule that contradicts the preferences of the Executive, the veto or the revision of the rule can occur along the RIA analysis. Higher severity in the analysis - the space of subjectivity about the definition of the benefits and the costs make this possible - can be made without necessarily some arbitrariness occurring. There is no problem, under the point of view of the regulatory credibility, if the standard of analysis of the costs and benefits changes. But this change must be presented in a transparent way and without the disruption of the procedures of the regulatory process.

## **V. THE PRESIDENTIAL CONTROL ON REGULATORY POLICY**

The American agency in charge of the proposals reviews of the agencies in the area of the federal regulation is the *Office of Information and Regulatory Affairs* (OIRA), of the *Office of Management and Budget* (OMB), that it is an agency inside of the Executive Cabinet of the President. The next section will present a brief summary of the evolution of the presidential monitoring on the American government regulatory policies. The

following section has the purpose to describe the process of review of the norms submitted by the agencies to the OIRA.

Until the beginning of the 1970`s, the presidential review of regulatory norms created by agencies only occurred in an informal way. However, with the growth of the regulation, it became more difficult not only the Presidency to monitor the quality of the rules, but also the consistency with its own policies.<sup>20</sup>

The first effort to centralize the process of regulatory review occurred in 1971, during the Nixon Government, with the program “Quality of Life”. The Quality of Life Review was the first mechanism to require agencies conduct regulatory analyses of proposed rules and to submit their regulations to the Office of Management and Budget prior to their publication in the Federal Register.

This process was deepened during the Ford Administration by means of the Executive Order n° 11,821 (Inflation Impact Statements), which required that major regulatory proposals (over \$ 100 million in impact) “be accompanied by statement which certifies that the inflationary impact of the proposal has been evaluated”. With these rules, the agencies had had to evaluate the impacts of its main proposals on costs, wages and prices of goods and services. To manage this process of review, the Council on Wage and Price Stability (CWPS) was created. In according to Viscusi, Vernon and Harrington (2000), the influence on the regulatory process started to happen in two stages:

*“First, the Council on Wage and Price Stability filed its comments on the regulatory proposal in the public Record as part of the rulemaking process. Second, these comments in turn provided the basis for lobbying with the regulatory agency by various members of the Executive Office of the President. Chief among these participants were members of the President’s Council of Economic Advisors and the president’s domestic policy staff”<sup>21</sup>.*

In 1978, President Carter issued the Executive Order n° 12.044. One of its intentions is that regulatory proposals “shall not impose unnecessary burdens on the economy, on individuals, on public or private organizations, or on local State and governments”.

---

<sup>20</sup> See Gattuso, James L (2002)

<sup>21</sup> Pag. 24

Agencies must identify which are the most significant regulations and carry through analysis of regulatory impact. In these analyses, “alternative approaches have been considered and the least burdensome of the acceptable alternatives has been chosen”(Cost-effectiveness test). The executive order also determined that the agencies “shall publish at least semiannually an agenda of significant regulations to under development or review”. With the objective to manage the semi-annual agenda was created the Regulatory Council, with the task, among other powers, to identify duplicities, superposition and contradictory rules. It was also created, during the Carter Government, the Regulatory Analysis Review Group (RARG), an interagency group, of collegiate nature, with the objective to review the regulatory analysis of the main regulations, beyond the OIRA, established in 1980 by the Paperwork Reduction Act.

The Reagan Government carried through important institutional changes on the mechanism of regulatory supervision. On February 17, 1981, Reagan signed the Executive Order, nº 12,291, that revoked Carter’s Executive Order. Amongst the most important changes introduced, the new executive order began to require from the agency the application of the cost-benefit test:

- (a) Administrative decisions shall be based on adequate information concerning the need for and consequences of proposed government action;*
- (b) Regulatory action shall not be undertaken unless the potential benefits to society for the regulation outweigh the potential costs to society;*
- (c) Regulatory objectives shall be chosen to maximize the net benefits to society;*
- (d) Among alternative approaches to any given regulatory objective, the alternative involving the least net cost to society shall be chosen; and*
- (e) Agencies shall set regulatory priorities with the aim of maximizing the aggregate net benefits to society, taking into account the condition of the particular industries affected by regulations, the condition of the national economy, and other regulatory actions contemplated for the future.*

Another important change was the centralization of the OIRA’s monitoring function, before shared among many offices. The agencies had started to be obliged to prepare a regulatory impact analysis of the main rules and send them to the OIRA, remaining without publication until the conclusion of the OIRA’s review. Besides that, OIRA can overlap the agency if considering that one specific rule is “major”, considering the existence of certain subjectivity in the definition of “major rules”:



*"Major rule" means any regulation that is likely to result in:*

- (1) An annual effect on the economy of \$100 million or more;*
- (2) A major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or*
- (3) Significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets.*

According to Eads (1981),

*"The order gives OIRA extremely broad powers. It can overrule agency determinations on whether a proposed rule is to be considered "major". In the case of a major rule, it must receive the draft regulatory impact analysis at least sixty days before the agency publishes the Notice of Proposed Rulemaking. If it find the analysis weak or believes that important alternatives have been neglected, it can delay publication of the Noticed of Proposed Rulemaking until de agency has adequately responded to its concerns. There is no requirement that a record be kept of these initiatives or of the agency's response. The agency may appeal only to the President's Task Force on Regulatory Relief or to the President himself".<sup>22</sup>*

There were no significant changes in the process of regulatory monitoring during the Government of President George H.W. Bush. It is important to register the creation of the Competiveness Council, headed by the Vice-president. The Council lasted until the end of the Government and had the objective to revise particular rules that believed to have significant impact on the economy or specific industries.

The Executive Order n° 12.291, established in the time of Reagan and Bush governments, fell back with Clinton and was replaced by the Executive Order n° 12.866, of September 30, 1993. The new executive reaffirmed the necessity of the cost-benefit analysis, however recognizing that many costs and benefits are hard to be quantified and that only effect qualitatively measurable should be considered in the analysis. The document also restricted the scope of the regulations that had passed to be submitted to the OIRA's review, reaffirmed "the primacy of Federal agencies in the regulatory decision-making process", and became the process accessible and opened to the public.

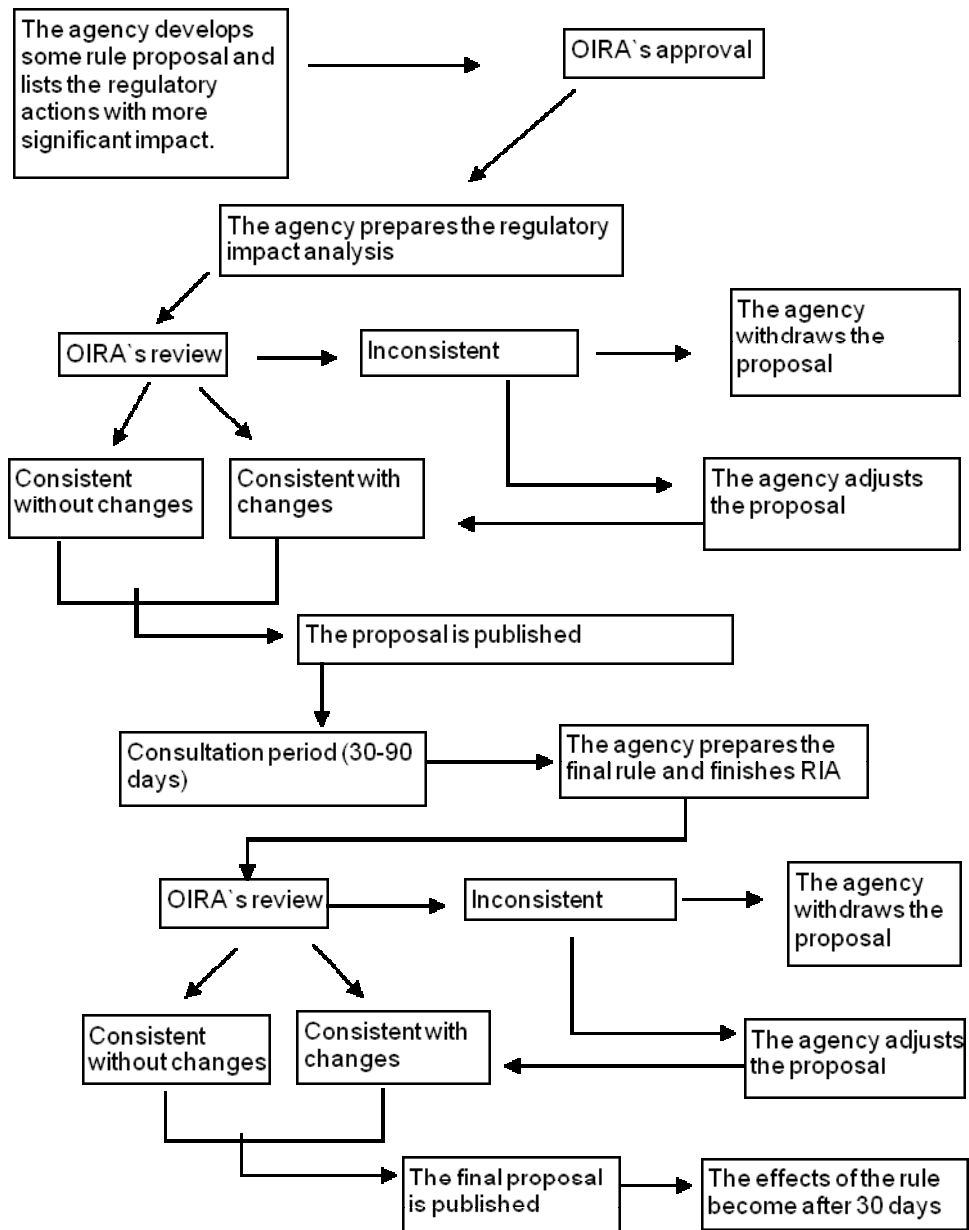
---

<sup>22</sup> Eads, George (1981)

The Executive Order n° 12,866 remained in validity during the Government of George W. Bush.

The figure in the following page presents the process of regulatory review carried through by OIRA. The agency decides to formulate a regulatory proposal and sends it to OIRA with a list of the actions of more significant impact. This first stage has just an informational character and has the objective to identify controversial questions with other agencies. After the OIRA's approval, the agency prepare the regulatory impact analysis and directs the proposal to OIRA sixty days before of Notice of Proposed Rulemaking (NPRM) in *Federal Register*. If OIRA considers that the proposal is well justified and consistent with the regulatory principles established in the EO 12866 or with the policies and priorities of the President, the agency can publish the NPRM. In few cases, the proposal is rejected. Most of the time, the proposal is considered consistent by OIRA, with or without alterations. After the publication of the NPRM, the proposal is open for public consultation for a period between 30 and 90 days. The agency incorporates the result of the consultation in the proposal and finishes the RIA, submitting again to OIRA. OIRA has one month to make the review and decide if the proposal can be approved and be published as a final rule in *Federal Register*.

**FIGURE 1 - OIRA'S REVIEW PROCESS**



Source: CRS Report Will be Congress, Uptaded May 28, 2004. The Library of Congress

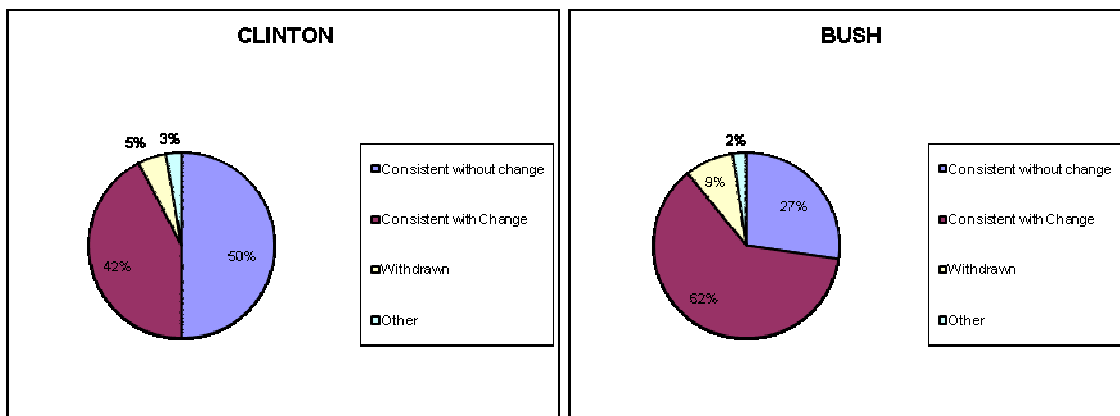
## VI. OIRA PERFORMANCE IN CLINTON AND BUSH ADMINISTRATIONS

All of the data of this section had been extracted of RegInfo.gov (<http://www.reginfo.gov/public/>), a website of the government of the United States produced by the Office of Management and Budget (OMB) and by the General Services

Administration (GSA). The website lays out the number of rules reviewed for the OIRA on three categories: number of rules and economically significant rules reviewed and average review times, by stage of rulemaking and by OIRA conclusion action. The selected periods were the Governments of Clinton ((01/20/1993 to 01/19/2001) and Bush (01/20/2001 to the 01/19/2009).

During the Clinton administration, OIRA evaluated 6219 rules, 17.6% more than the number of rules reviewed during the Bush period (5125). It is not a surprise to note the fact that OIRA had received a higher number of rules for reviews from the agencies during the Clinton period, since its administration tended to be less rigid in the process of regulatory analysis, as the graph to follow:

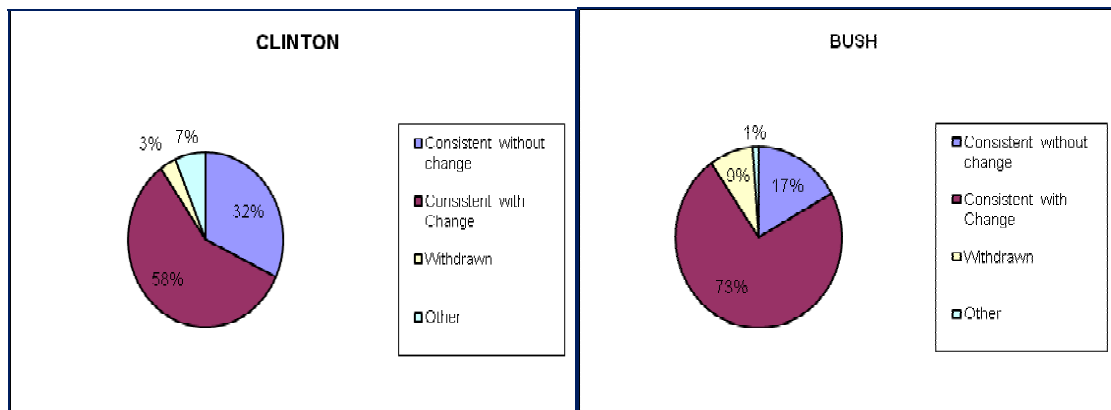
**GRAPH 3 - REVIEWS BY OIRA CONCLUSION (%)**



During the Bush Government, only 27% of the rules had been considered consistent without change, whereas during the Clinton Government, this percentage was almost the double. There was, also, an increase of 43% (305 to 436) of the number of rules withdrew by OIRA during the Bush Administration, if compared to the previous administration. The data confirm not only the common sense that Clinton was more pro-regulatory than Bush, but also the foresight of the model presented in section 3. If the perception of ideological convergence exists between Presidency and regulators in favor of the regulation, the regulators will have strong incentives to submit a high number of proposals because the probability of the proposal to be modified or rejected is low.

If only the rules with significant impact are considered, although the process of regulatory review had been more severe in both administrations, the differences remain substantial:

**GRAPH 4 - REVIEWS BY OIRA CONCLUSION (%) - ECONOMICALLY SIGNIFICANT**



Therefore, there are elements showing that the presidential control on the regulatory policies not only has the objective increasing the quality of the regulation, but also making adjustments on the regulatory policy of the ideological tendency of the Presidency. How this objective was reached in the Clinton and Bush administrations? A possibility is that the presidential control has been exerted by procedural way. According to McCubbins, R. Noll & B.R. Weingast (1987), the legislators will choose the shape of the structure organization of the regulatory agency and the procedures to be followed with the intention to control its policies. For example, a pro-regulatory administration will tend to establish a less complex set of procedures making the regulatory process faster.

As seen before, we did not see important changes in the process of regulatory oversight during G.W. Bush Government. The Executive Order nº 12,866, established by Clinton in 1993, remained in validity during the following Government. Anyway, there are many ways of influencing or slowing the regulatory process. The central agency of regulatory control (in this case, OIRA), for example, could increase the analysis period. As seen in section 4, there is some subjectivity in the definition of “major rules”, which it allows OIRA overlapping the agency if some specific rule is considered “major”. Another way is the requirement of public consultations, that not only delays the

implementation of the rule, but also allows the involvement of interests groups associated to the Presidency, making possible the creation of “fire alarms ” in the case of proposals that are contrary to its interests.

Shapiro (2007) made a study comparing the regulatory process under Clinton and G.W. Bush administrations. The data – all final rules sent during the first term of Bush and the Clinton`s second term - had been obtained from the Federal Register (<http://www.gpoaccess.gov/fr/index.html>). The website of the Federal Register only has data from 1998. The data of the website RegInfo.gov had been evaluated too. The conclusion of the study is that the regulatory process was quite similar between the two administrations, despite of the substantive differences in terms of regulatory policies.

The table below presents the revisions concluded for the OIRA by category.

**CHART 1 – REVIEWS BY TYPE**

	<b>CLINTON</b>	<b>BUSH</b>
Were Economically Significant?	732	755
Were Major?	369	689
Imposed Unfunded Mandates?	81	137
Required the Regulatory Flexibility Analysis?	1040	571
Small Entities Affected?	195	670
Had Federalism Implications?	75	341
Were Related to the Homeland Security?	*	346
Final Were Rules Only?	2060	2007

\* The site does not inform

According to Shapiro (2007), what we could expect from some regulatory administration? In first place, it would be reasonable waiting the agencies issuing a higher number of rules causing significant impact (Were economically significant? Were major?). But It has little difference on the number of rules considered economically significant evaluated for the two administrations. Even in percentile terms, this difference is not expressive (12% in the Clinton Government and 15% in the Bush Government). It`s worth noting that the definition of “economically significant” is not identical to definition of “major”<sup>23</sup>. In this last category, the difference in the number of rules that had been considered “major” was more perceptible.

<sup>23</sup> Significant regulatory action is defined as any regulatory action that "will likely result in a rule that may:

Another hypothesis is that perhaps a pro-regulatory administration could review a bigger number of rules that affects small entities (Required regulatory flexibility analysis? Small entities affected?). Again, any significant difference is not noted when considering the both categories together.

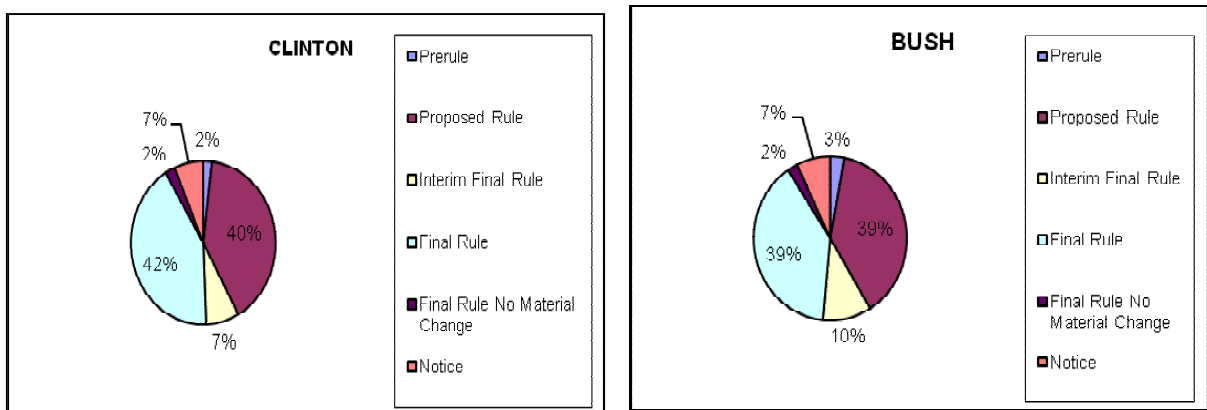
A third hypothesis is that a pro-regulatory administration would be subject to reviewing a bigger number of rules that impose higher budgetary costs (Imposed unfunded mandates?). This is not also verified. In truth, the numbers in the chart does not support this hypothesis.

Two qualifications have to be made. In first place, the RegInfo does not inform the total number of issued rules. Therefore, it is not possible to know, reading the data of the chart above, if the percentage of the reviews demanded by OIRA in relation to the total of issued rules diverges between the two administrations. Moreover, we observe that the reviewed rule can be classified in more than one category. For example, a rule can affect small entities and have federative implications and/or be “major”.

The number of final rules is also an important variable. The federal rules can be opened (proposed rules) or closed (final rules) to the public consultation. An anti-regulatory administration would tend to open the regulatory process for a bigger number of consultations, not only in order to delay the process, but also to make difficult the approval of the rule. According to the chart, the number of final rules is very similar between the two administrations. Even looking at the percentages, it is not observed strong divergence too (Graph 5).

- 
1. "Have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities;
  2. "Create a serious inconsistency or otherwise interfere with an action taken or planned by another agency;
  3. "Materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or
- "Raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in this Executive order."

### GRAPH 5 - BY STAGE OF RULEMAKING



The following chart presents the average review time of the rules during the two Governments. The time of analysis of the rules considered economically significant was almost identical during the two periods.

### CHART 2 - AVERAGE REVIEW TIME (DAYS)

	CLINTON	BUSH	Δ %
Economically Significant	45	43	-4,4
Not Economically Significant	44	57	29,5
ALL	44	55	25,0

Conclusion:

- a) The biggest number of reviews and lesser severity in the regulatory process suggest that Clinton was more pro-regulatory than Bush, as it indicates the common sense.
- b) Despite founding substantial differences in terms of results, in general, the data do not indicate significant differences about the degrees of opening of the regulatory process to the public as well the time of analysis.



- c) It was not also observed relevant disparities in relation to the framing of the rules in the categories of analysis (with exception of the category “major”). It is worth to note that the evaluation is incomplete since we do not have information about the ratio between rules reviewed and issued by the agencies;
- d) Anyway, we can conclude that the substantial differences between the two administrations in terms of results are not justified only by procedural manipulation.

How to explain the differences found in terms of results of the regulatory process? In accordance with our hypothesis, the obligation of the agency to submit an analysis of regulatory impact to a central agency already reduces its autonomy. As the cost-benefit analysis is associated with high uncertainty degree, most part of the evaluation tends to be qualitative. It is important to observe that the existence of mechanisms of check-and-balances and the high degree of official document transparency (despite the transparency is not absolute) reduces the Executive’s room to maneuver alterations in the standards of analysis of the rules in a discretionary way. Therefore, we can conclude that RIA allowed the Clinton and Bush administrations to increase their capacities to assure its regulatory objectives without explicit procedural manipulation or arbitrary actions.

## **CONCLUSIONS**

RIA is an instrument of presidential control on the rules formulated by regulatory agencies. Therefore, its introduction means the decrease of the Brazilian agencies autonomy. But these agencies, according to the view of the Executive branch, enjoy excessive autonomy, in the sense that its autonomy is not political and should be restricted to the operational ground. Politically independent agencies result in technocracy, that is, an inappropriate interference of the regulator in the process of formulating public policies, without democratic legitimacy.

As a consequence of RIA implementation, would the decrease of the autonomy of the agencies negatively affect the credibility of the regulatory policies? The Latin American States are seen by private sector as weak organizations, incapable of resisting against

the pressures for subsidies and protection, besides being too flexible in the law enforcement. In this sense, autonomy is a relevant variable to provide credibility in the region because it supplies some safety against the expropriation and administrative discretion.

Another issue to be considered is related to the nature of the links between agencies and Executive and Legislative powers. A specific feature of the institutional framework of the Brazilian regulatory policies is the low control degree of the Legislative branch on the actions of the agency. As institutional mechanisms linking the agency with the Legislative do not exist, the control tends to be low and restricted to specific situations. In contrast to what happens in US, the Congress commissions seem to have little power in Brazil, not being, in a first view, a determinative force in the process of formulation and oversight of regulatory policies. This asymmetry of institutional capabilities of control between the two powers can increase with the introduction of a RIA's system, which includes a central body like OIRA.

On the other hand - although the autonomy of the agency is decreasing - the introduction of RIA can produce a positive effect on regulatory credibility if the system establishes adequate mechanisms of check-and-balances. The requirement of RIA corresponds to the best international practices. In this direction, the loss of agencies' autonomy can be balanced by the introduction of a control instrument considered legitimate by the market. Moreover, the effort of evaluating costs and benefits of the introduction of regulatory norms, even complicated and subjective, will probably result an increase of the regulatory quality.

Dealing with the uncertainty is more important to firms than the ideological agenda of the Government. This is not easy in situations where the rules are modified or not respected. In this sense, the introduction of RIA may reduce the ideological cost – that is, increasing the capacity of the Government to assure its regulatory objectives while a stable regulatory environment is preserved. Nevertheless, regulatory stability does not necessarily mean better regulatory quality.

Rather than maximize social welfare, Governments introduce RIA to maximize its own benefits. This comes from the Chicago School's premise about the economic rational

behavior applied on the political world. Without check-and balances mechanisms, transparency and active participation of the affected parties (firms and consumers), RIA hardly will result on better regulatory quality. In fact, it will be only a tool to help Governments to achieve its political benefits without making radical changes in the regulatory framework.

The only way to obtain credibility and better regulation is to assure that the rules of the regulatory process of control on the regulators` decisions will not be manipulated and this process will be transparent for Congress and civil society. As a consequence, the body in charge of RIA will not have incentives to make an analysis excessively biased about the costs and benefits of the proposal – which is, of course, socially inefficient. Hence, the creation of adequate incentives is a central issue in the discussions about the Brazilian regulatory reform.

## REFERENCES

AKERLOF, G. (1970), “The Market for “Lemons”: Qualitative Uncertainty and the Market Mechanism”. *Quartely Journal of Economics* 84.

BECKER, Gary S. (1983), “A Theory of Competition Among Pressure Groups for Political Influence”. *Quartely Journal of Economics* 98 (August).

BOSCHI, Renato R. & LIMA, Maria Regina Soares de. (2002), “O Executivo e a Construção do Estado no Brasil: do Desmonte da Era Vargas ao Novo Intervencionismo Regulatório”, *mimeo*, IUPERJ.

EADS, George (1981). *Harnessing Regulation: The Evolving Role of White House Oversight in Regulation* , Vol. 5, (May/June 1981).

GATTUSO, James L (2002). *Regulating the Regulators: OIRA’s Comeback*. Heritage Foundation *Executive Memorandum* No. 813, May 9, 2002, at [www.heritage.org/Research/Regulation/EM813.cfm](http://www.heritage.org/Research/Regulation/EM813.cfm)

GUASCH, Luis J. & SPILLER, Pablo. (1999), *Managing the Regulatory Process: Design, Concepts, Issues and the Latin America and Caribbean Story*; World Bank Latin American and Caribbean Studies; The World Bank; Washington, D.C.

JORDAN, William A. (1972), "Producer Protection, Prior Market Structure and the Effects of Government Regulation". *Journal of Law and Economics* 15: 151-76

KALT, J.P. & ZUPAN, M.A. (1990), "The Apparent Ideological Behavior of Legislators: Testing for Principal-Agent Slack in Political Institutions", 33 *Journal of Law and Economics*.

LEVY, Brian & SPILLER, Pablo T. (1996), "A Framework for Resolving the Regulatory Problem"; em *Regulations, Institutions, and Commitment – Comparative Studies in Telecommunications*; Levy, Brian & Spiller, Pablo T. ( ed.), Cambridge University Press.

MAJONE, Giandomenico (1999). "Do Estado positivo ao Estado regulador: causas e consequências de mudanças no modo de governança". *Revista do Serviço Público*, ano 50, número 1, jan/mar 1999, ENAP, Brasília.

MCCUBBINS, M.D., NOLL, R.G. & WEINGAST, B.R. (1987), "Administrative Procedures as Instruments of Political Control", *Journal of Law Economics and Organization*, 3, 234-277.

MEIER, Kenneth J.( 1985), *Regulation – Politics, Bureaucracy, and Economics*; St. Martin's Press, New York.

MELO, Marcus André. (2001), "A Política da Ação Regulatória: Responsabilização, Credibilidade e Delegação". *Revista Brasileira de Ciências Sociais* nº 46.

NAO (2002). *Better Regulation: Making Good Use of Regulatory Impact Assessment*, HC 329 (London)

NISKANEN, William. (1973), *Bureaucracy: Servant or Master? Lessons from America*. London, The Institute of Economic Affairs.

NORTH, Douglas C (1990). *Institutions, Institutional Change and Economic Performance*; Cambridge University Press; Cambridge.

OECD (2007). *Building a framework for conducting Regulatory Impact Analysis (RIA): tools for policy-makers*. <http://www.oecd.org/dataoecd/12/50/38706266.pdf>.

OLSON, Mancur Jr. (1968), *The Logic of Collective Action: Public Goods and the Theory of Groups*, Harvard University Press.

PELTZMAN, S. (1976), “Towards a More General Theory of Regulation”. *The Journal of Law and Economics* ( August): 211-40

PÓ, Marcos. V. & ABRUCIO, Fernando. L. (2006), “Desenho e funcionamento dos mecanismos de controle e *accountability* das agências reguladoras brasileiras: semelhanças e diferenças”. *Revista de Administração Pública*. Rio de Janeiro 40 (4):679-98, Jul /Ago. 2006.

POSNER, Richard A. (1974), “Theories of Economic Regulation”. *Bell Journal of Economics and Management Science* 5: 335-58.

RADAELLI, Cláudio M. (2002) “The Politics of Regulatory Impact Analysis in the OECD Countries: Best Practice and Lesson-Drawing”. Paper delivered to the workshop on *Regulatory Impact Analysis in Comparative Perspective*. CARR, LSE, London, 11 march 2002.

SCHERER, F.M. & ROSS D. (1990), *Industrial Market and Economic Performance*, Boston: Houghton Mifflin.

SCHUMPETER, J (1961), *Capitalismo, Socialismo e Democracia*, Ed. Fundo de Cultura.

SHAPIRO, Stuart (2007). "Presidents and Process: A Comparison of the Regulatory Process Under the Clinton and Bush (43) Administrations". Available at: [http://works.bepress.com/stuart\\_shapiro/1](http://works.bepress.com/stuart_shapiro/1)

SIGMA (2001). "Improving Policy Instruments through Impact Assessment". *SIGMA Paper* n° 31. Paris: OECD

SPILLER, P.T. (1990), "Politicians, Interest Groups, and Regulators: A Multiple-Principals Agency Theory of Regulation or "Let Them Be Bribe""", 33 *Journal of Law and Economics*.

STIGLER, George J. (1971), "The Theory of Economic Regulation". *Bell Journal of Economics and Management Science* 3: 1-21.

STIGLER, George J. & FRIENDLAND, Claire. (1962), "What Can Regulators Regulate? The Case of Electricity". *Journal of Law and Economics* 5: 1-16.

TRAIN, Kenneth E. (1995), *Optimal Regulation – The Economic Theory of Natural Monopoly*, Cambridge, The MIT Press.

VISCUSI, W. Kip, Vernon, John M. & Harrington, Joseph E. (2000), *Economics of Regulation and Antitrust*, Cambridge, The MIT Press.

WEINGAST, B.R. & MORAN, M.J. (1983). "Bureaucratic discretion or congressional control? Regulatory Policymaking by the Federal Trade Commission." *Journal of Political Economy* 91(5): 765-800.

WILSON, James Q. (1974), "The Politics of Regulation". *Social Responsibility and the Business Predicament* (ed. James McKie), Brookings Institution