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Recommended Citation

Peter L. Kahn, *Politics of Unregulation: Public Choice and Limits on Government*, 75 Cornell L. Rev. 279 (1990)
Available at: <http://scholarship.law.cornell.edu/clr/vol75/iss2/2>

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THE POLITICS OF UNREGULATION: PUBLIC CHOICE AND LIMITS ON GOVERNMENT

Peter L. Kahn †

I

Many economists and economically-minded lawyers in recent years have come to view much governmental regulation of business as the unfortunate result of a perverse quirk in our political system.¹ In this view, representative democracy gives unwarranted weight to the interests of small and discrete pressure groups, whose interests may be directly opposed to the interests of the larger public.² Through an analysis of the effect of the size of a lobbying group on its political effectiveness,³ advocates of this view (hereinafter described as “public choice theory” or the economic theory of legislation) have concluded that small groups of beneficiaries are more effective in lobbying for special interest legislation than those larger groups which pay the bills are in resisting it. As a result, most regu-

† Legal Advisor to the Vice Chairman, U.S. International Trade Commission. I wish to thank Thomas Arthur, Roger Hickey, Seth Kaplan, Errol Meidinger, and Stephen Narkin for their comments. The views I express here are not necessarily those of the U.S. International Trade Commission, or of any individual other than myself.

¹ See, e.g., JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT* (1962); *THE CRISIS OF THE REGULATORY COMMISSIONS* (P. MacAvoy ed. 1970); WILLIAM A. NISKANEN, *BUREAUCRACY AND REPRESENTATIVE GOVERNMENT* (1971); ROGER G. NOLL, *REFORMING REGULATION* (1971); *PROMOTING COMPETITION IN REGULATED MARKETS* (A. Phillips ed. 1975); WILLIAM H. RIKER, *THE THEORY OF POLITICAL COALITIONS* (1962); Gary S. Becker, *Pressure Groups and Political Behavior*, in *CAPITALISM AND DEMOCRACY: SCHUMPETER REVISITED* 120 (R. Coe & C. Wilbur eds. 1985); Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 371 (1983); Stephen Breyer & Paul W. MacAvoy, *The Natural Gas Shortage and the Regulation of Natural Gas Producers*, 86 HARV. L. REV. 941 (1973); Daniel A. Farber & Philip P. Frickey, *The Jurisprudence of Public Choice*, 65 TEX. L. REV. 873 (1987); William A. Jordan, *Producer Protection, Prior Market Structure and the Effects of Government Regulation*, 15 J.L. & ECON. 151 (1972); Joseph P. Kalt & Mark A. Zupan, *Capture and Ideology in the Economic Theory of Politics*, 74 AM. ECON. REV. 279 (1984); Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976); Richard A. Posner, *Taxation by Regulation*, 2 BELL J. ECON. & MGMT. SCI. 22 (1971); Richard A. Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. 335 (1974); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971), reprinted in GEORGE J. STIGLER, *THE CITIZEN AND THE STATE* 114 (1975). Indeed, in the view of Kalt & Zupan, *supra*, at 279, “the economic theory of regulation long ago put public interest theories of politics to rest.”

² This view is not entirely a new one. See *THE FEDERALIST* No. 10, at 77-84 (James Madison); *THE FEDERALIST* No. 51, at 320-25 (James Madison) (Clinton Rossiter ed. 1961).

³ See MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION* (1971).

lation is viewed as merely special interest legislation designed to serve some politically powerful group at the expense of the public. Empirical investigation of many regulatory programs has revealed large social costs, small public benefits, and (often) substantial transfers from the public to some discrete group, typically the industry ostensibly controlled by the regulatory program.⁴

This view of regulation has become remarkably influential in the last decade or so. It has had some notable legislative successes, in particular the deregulation of the trucking industry and the airlines.⁵ It was the chief rationale for the Reagan Administration's efforts at "deregulation,"⁶ and its resistance to new regulatory ac-

⁴ See, e.g., BRUCE A. ACKERMAN & WILLIAM T. HASSLER, CLEAN COAL/DIRTY AIR 44-48 (1981); ROBERT W. CRANDALL, CONTROLLING INDUSTRIAL POLLUTION 110-30 (1983); INSTITUTE FOR CONTEMPORARY STUDIES, REGULATING BUSINESS: THE SEARCH FOR AN OPTIMUM (1978); E. Donald Elliott, Bruce A. Ackerman & John C. Millian, *Toward a Theory of Statutory Evolution: The Federalization of Environmental Law*, 1 J.L. ECON. & ORG. 313 (1985); Robert N. Leone & John E. Jackson, *The Political Economy of Federal Regulatory Activity: The Case of Water Pollution Controls*, in STUDIES IN PUBLIC REGULATION (G. Fromm ed. 1981); James C. Miller & Thomas F. Walton, *Protecting Workers' Hearing: An Economic Test for OSHA Initiatives*, REGULATION, Sept./Oct. 1980, at 31; B. Peter Pashigian, *The Effects of Environmental Regulation on Optimal Plant Size and Factor Shares*, 27 J.L. & ECON. 1 (1984). For a critical evaluation of some of this empirical work, see Mark Kelman, *On Democracy-Bashing: A Skeptical Look at the Theoretical and "Empirical" Practice of the Public Choice Movement*, 74 VA. L. REV. 199 (1988).

⁵ For example, the Office of Management and Budget ("OMB") effectively "deregulated" airport landing rights by forcing a change in the method by which they were regulated. See High Density Traffic Airports; Slot Allocation and Transfer Methods, 14 C.F.R. §§ 11, 93 (1988). The Office of Management and Budget has offered the economic theory of regulation as the rationale for the adoption of the major deregulatory initiatives of the last decade. See Office of Management and Budget, Executive Office of the President, Regulatory Program of the United States Government, April 1, 1988 to March 31, 1989, at 6 (1988) [hereinafter OMB Regulatory Program]; Michael E. Levine, *Revisionism Revised? Airline Deregulation and the Public Interest*, LAW & CONTEMP. PROBS., Winter 1981, at 179-80.

⁶ The argument was a principal rationale for the centralization of regulatory review authority in the Office of Management and Budget, pursuant to Exec. Order No. 12,291, 3 C.F.R. 127 (1982), reprinted in 5 U.S.C. § 601, at 431 (1982). See, e.g., Christopher C. DeMuth & Douglas H. Ginsburg, *White House Review of Agency Rulemaking*, 99 HARV. L. REV. 1075, 1081 (1986). The OMB review process has significantly decreased the number of regulations issued, caused some reversal of prior rules, and forced the agencies to tailor many of the new regulations so that they rely on market incentives rather than overt direction from the regulatory agency. See OMB Regulatory Program, *supra* note 5, April 1, 1985 to March 31, 1986, app. III, exhibits 12-15 (1985). For example, the Environmental Protection Agency substantially reduced the restrictiveness of its proposed asbestos exposure standard in response to OMB commentary. See EPA's *Asbestos Regulations: Hearing Before the Subcomm. on Oversight and Investigations of the House Comm. on Energy and Commerce*, 99th Cong., 1st Sess. (1985); Asbestos: Proposed Mining and Import Restrictions and Proposed Manufacturing, Importation, and Processing Prohibitions, 51 Fed. Reg. 3738-59 (1986); see also STAFF OF HOUSE COMM. ON ENERGY AND COMMERCE, SUBCOMM. ON OVERSIGHT AND INVESTIGATIONS, 98TH CONG., 2D SESS., INVESTIGATION OF THE ENVIRONMENTAL PROTECTION AGENCY: REPORT OF THE PRESIDENT'S CLAIM OF EXECUTIVE PRIVILEGE OVER EPA DOCUMENTS, ABUSES IN THE SUPERFUND PROGRAM, AND OTHER MATTERS 285 (1984) (OMB forced EPA to eliminate proposed rule

tions by federal agencies.⁷ It has also to some degree altered the treatment the federal courts accord to regulatory schemes and the behavior of regulatory agencies.⁸

Indeed, so successful have these arguments become that there are now serious proposals to change the legal process or the political system to reduce the ill effects of the alleged political bias. For example, some writers have proposed that the courts impose a rigid form of the non-delegation doctrine to ensure that Congress, and not the federal regulatory agencies, originates all but the most detailed regulatory rules; the asserted benefit would be to raise the costs of these actions by making them as visible as possible, thereby reducing the likelihood such special interest regulation would be passed.⁹ Some urge that the courts work actively to obstruct special interest deals by explicitly refusing to give them effect;¹⁰ others have proposed that the courts obstruct the special interest deals made in Congress by enforcing, not the explicit terms of the deal embodied

dealing with water quality under the Clean Water Act). OMB has also tried to prevent the implementation of agency rulemaking by delay, for example by delaying the required notice of proposed rulemaking beyond the statutory deadline. See *Environmental Defense Fund v. Thomas*, 627 F. Supp. 566 (D.D.C. 1986); cf. Paul R. Verkuil, *Welcome to the Constantly Evolving Field of Administrative Law*, 42 ADMIN. L. REV. 1, 2 (1990) ("The importance of the rulemaking evaluation and paperwork reduction rules of the Office of Information and Regulatory Analysis of the Office of Management and Budget is difficult to overstate. As a practical matter, OMB now largely determines the regulatory agenda and by extension the President's legislative program."). For Presidential actions implementing deregulation, see Exec. Order No. 12,291, *supra*; President's Memorandum to Executive Branch Agencies, 17 WEEKLY COMP. PRES. DOC. 73-74 (Jan. 29, 1981); Postponement of Pending Regulations, 46 Fed. Reg. 11,227 (1981); Press Release, Presidential Task Force on Regulatory Relief, Reagan Administration Regulatory Achievements 67-68 (Aug. 11, 1983); OMB Regulatory Program, *supra* note 5, April 1, 1988 to March 31, 1989 (1988).

⁷ See OMB Regulatory Program, *supra* note 5, April 1, 1988—March 31, 1989, at 6 (1988); see also Christopher DeMuth, *Regulation, Productivity, and the Reagan Administration's Regulatory Program*, in REGULATORY REFORM RECONSIDERED 21 (G. Daneke & D. Lemak eds. 1985); DeMuth & Ginsburg, *supra* note 6, at 1080-81.

⁸ See generally *Motor Vehicle Mfrs. Ass'n of United States v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983) (finding that the National Highway Traffic Safety Administration's rescission of a new motor vehicle requirement for automatic seatbelts and airbags arbitrary and capricious); Merrick B. Garland, *Deregulation and Judicial Review*, 98 HARV. L. REV. 507 (1985).

⁹ See, e.g., Peter H. Aranson, Ernest Gellhorn & Glenn O. Robinson, *A Theory of Legislative Delegation*, 68 CORNELL L. REV. 1 (1982). The authors concede that this proposal will discourage truly public-regarding legislation along with "the legislative production of private goods." *Id.* at 64. However, they justify this cost by arguing that there will be little public-regarding legislation in any case. See *infra* text accompanying notes 42-47, 56-57.

¹⁰ See, e.g., BERNARD SIEGAN, *ECONOMIC LIBERTIES AND THE CONSTITUTION* (1980); Richard A. Epstein, *Taxation, Regulation, and Confiscation*, 20 OSOODE HALL L.J. 433, 438 (1982); Richard A. Epstein, *Toward a Revitalization of the Contract Clause*, 51 U. CHI. L. REV. 703 (1984) [hereinafter Epstein, *Contract Clause*]; Jerry L. Mashaw, *Constitutional Deregulation: Notes Toward a Public, Public Law*, 54 TUL. L. REV. 849 (1980); Richard A. Epstein, *Needed: Activist Judges for Economic Rights*, Wall St. J., Nov. 14, 1985, at 32, col. 4.

in the legislation, but the lofty-sounding purposes often enshrined in the preambles to legislation.¹¹ Still others have urged that the federal courts adopt a more deferential standard of review of agency action when the agency is removing regulations than when it is imposing them.¹² And some have called for the extension of federal antitrust law to prevent the regulation of economic activity by the states, on the theory that "state regulation is simply the extension of private monopolistic activity into the governmental sphere."¹³ Indeed, the list could go on at some length.¹⁴ Even the notorious (and notoriously unsuccessful) proposed balanced budget amendment has been justified as a structural reform of the legislative rules to eliminate an alleged bias in favor of special interest spending.¹⁵

¹¹ See Jonathan R. Macey, *Promoting Public Regard for Legislation through Statutory Interpretation: An Interest Group Model*, 86 COLUM. L. REV. 223, 252-66 (1986). Though Macey urges that courts continue to apply traditional methods of statutory construction, he argues that "judicial review is not now a major obstacle to special interest legislation." *Id.* at 225 n.13. He urges the courts to return to the statutory interpretation practices of an earlier era, which would pose greater barriers to special interest legislation. For a contrary view of the implications of public choice theory for statutory interpretation, see Richard A. Posner, *Economics, Politics, and the Reading of Statutes and the Constitution*, 49 U. CHI. L. REV. 263 (1982). Macey argues that his own proposal will discourage legislation motivated by private interest, but will leave unimpeded legislation which truly serves the public interest. The latter claim is dubious. Discerning the true motives and effects of legislation is difficult at best, as Macey concedes. Macey, *supra*, at 228 n.24. A system which relies crucially on the distinction between public regarding and private regarding legislation can be expected to be extraordinarily cumbersome and inaccurate. As Macey has noted, even the most venal legislation is likely to be covered with a public interest fig leaf.

¹² *Active Judges and Passive Restraints*, REGULATION, July-August 1982, at 10 [hereinafter *Active Judges*]. This article was published anonymously but some have attributed it to then-Professor Antonin Scalia. See Note, *Judicial Review of Administrative Inaction*, 83 COLUM. L. REV. 627, 670 (1983) (authored by Peter H.A. Lehner).

¹³ William H. Page, *Interest Groups, Antitrust, and State Regulation: Parker v. Brown in the Economic Theory of Legislation*, 1987 DUKE L.J. 618, 620 (citing John Shepard Wiley, *A Capture Theory of Antitrust Federalism*, 99 HARV. L. REV. 713 (1986)); see also John Cirace, *An Economic Analysis of the "State-Municipal Action" Antitrust Cases*, 61 TEX. L. REV. 481 (1982).

¹⁴ See, e.g., RICHARD EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* 283-329 (1985) (certain tax and transfer programs should be constitutionally banned to prevent rent-seeking); Bruce A. Ackerman, *Beyond Carolene Products*, 98 HARV. L. REV. 713 (1985); Harold H. Bruff, *Legislative Formality, Administrative Rationality*, 63 TEX. L. REV. 207 (1984); Frank H. Easterbrook, *Foreword: The Court and the Economic System*, 98 HARV. L. REV. 4 (1984) (inferring private rights of action in statutes may violate the terms of agreements reached by interest groups in legislature); Frank H. Easterbrook, *Statutes' Domains*, 50 U. CHI. L. REV. 533 (1983) (statutes should be interpreted narrowly to limit the scope of legislative deals which redistribute wealth to interest groups); Epstein, *Contract Clause*, *supra* note 10 (Contract Clause should be strictly enforced to ensure a limited role for government in economic matters); Cass R. Sunstein, *Interest Groups in American Public Law*, 38 STAN. L. REV. 29 (1985).

¹⁵ See S. REP. NO. 628, 98th Cong., 2d Sess. 3 (1984). This proposal was made in JAMES BUCHANAN & RICHARD WAGNER, *DEMOCRACY IN DEFICIT: THE POLITICAL LEGACY OF LORD KEYNES* (1977). Buchanan and Wagner argue that the acceptance of Keynesian economics destroyed one element of the American "fiscal constitution," namely a balanced budget rule. GEOFFREY BRENNAN & JAMES M. BUCHANAN, *THE POWER TO TAX*

These proposals have emphasized the dangers inherent in politics, and have tried to ward off such dangers by building institutional barricades against any affirmative governmental action. In doing so, they have largely ignored the possibility that an alternative decision *not* to enact administrative regulation or legislation, or to remove existing governmental programs, might owe its success to the same forces. While the possibility that the interest group model might result in privately-generated pressure against any government regulation has been formally acknowledged on occasion in the literature,¹⁶ proposals such as those discussed here would ease the way for interest groups seeking to oppose public-regarding¹⁷ government actions by erecting new barriers to such actions, and would give such groups incentives to invest their lobbying funds in opposing such government actions.

This fundamental but essentially unjustified asymmetry in the treatment of governmental action and inaction has introduced into the public choice literature a bias against the use of government, and a corresponding overvaluation of private market outcomes. Though the underlying theory predicts only the relative political strength of small special interest groups in seeking their political goals, and not the nature of those goals or the role of government in achieving those goals, these proposals work systematically against government itself. In short, these prescriptions address only the affirmative use of government, when the theory in fact directs our attention to the dangers inherent in politics generally, whether political power is used to achieve or to prevent government action.

There is, after all, no rule of nature that the costs of proposed governmental actions must be spread more broadly than its benefits, nor a rule that the groups which oppose government action must be weaker than the groups which support it. Cases surely arise where the opposite pattern holds. Politicians, lobbyists, and activists¹⁸ have long pointed to the power of special interest groups in

(1980), examined a variety of proposals to limit the alleged tendencies of governments to increase their revenues beyond the desires of their constituents, including constitutional constraints on tax bases and rates.

¹⁶ See, e.g., Sunstein, *supra* note 14, at 29.

¹⁷ This language comes from Mashaw, *supra* note 10, at 868. The term has been used simply to denote legislation that is advocated for reasons that connote the public interest rather than the unique and distinct interests of the advocates. I recognize that Arrow's Theorem renders problematic the definition of a "public interest" in many cases. See Frank H. Easterbrook, *Ways of Criticizing the Court*, 95 HARV. L. REV. 802, 813 (1982). Similarly, the difficulties of discerning legislative intent obviously pose problems here as well. See Macey, *supra* note 11, at 228-29 n.29. The economic theory of legislation, however, poses more difficult problems for this definition because it purports to infer legislative intent from actual effect. See *infra* note 35.

¹⁸ See, e.g., MICHAEL PERTSCHUK, *REVOLT AGAINST REGULATION* (1982).

opposing regulation. One would expect at least some cases in which the absence of government, rather than its presence, indicated special interest influence.¹⁹ Concern for that possibility is conspicuously missing from the public choice literature.

The asymmetrical emphasis surely reveals a logical misstep. The public choice model relies for its conclusions only on the distributional effects of policies on competing interest groups. Yet, as demonstrated by these proposals to reduce the scope and flexibility of government, the public choice model has served to justify normative conclusions about those policies, conclusions which do not derive from the model itself.²⁰ There appears, therefore, to be an implicit assumption: either that the support of a benefitted group is evidence that the proposed policy contravenes the public interest,²¹ or that affirmative governmental action is undesirable for some reason not explicit in the model itself. The former assumption will

¹⁹ This surely is not uncommon. See, e.g., *id.* at 8 (discussing the influence of cotton and textile interests in reducing the regulatory standards governing fabric flammability).

²⁰ As Macey has observed, nothing in the economic theory of legislation precludes the possibility that some government actions may represent "wealth-increasing 'public interest' governmental activities" that should be encouraged. Furthermore, it is all but impossible to distinguish such activities from the "amorally redistributive" rent-seeking activities" that public choice theory has addressed. Jonathan R. Macey, *Transaction Costs and the Normative Element of the Public Choice Model: An Application to Constitutional Theory*, 74 VA. L. REV. 471, 472 (1988) (citations omitted). It is nevertheless a startlingly small number of regulatory programs examined in the pages of the *Journal of Law and Economics* which have been found to add much to the public interest. One could easily come away from a regular reading of this work with the impression that the government acts *only* to reduce the national welfare. See, e.g., Ronald A. Cass, *The Meaning of Liberty: Notes on Problems Within the Fraternity*, 1 NOTRE DAME J.L. ETHICS & PUB. POL'Y 777, 790 (1985) ("Take almost any government program at random, and a 'special interest' counter-majoritarian explanation can be found that is more plausible than the public interest justification given for it.") (citations omitted).

²¹ The meaning of "the public interest" has never been adequately defined in this literature. Commentators apparently assume that the "public interest" can be identified with reaching the Pareto-efficient resource allocation associated with the existing income distribution. In that context, of course, the political support for a policy is obviously a poor measure of its efficiency characteristics. However, Pareto-efficient allocations should not be identified with the public interest, since the Pareto criterion is distributionally neutral but social welfare functions need not be, and, to touch on reality for a moment, almost surely are not. Inefficient resource allocations with superior distributional characteristics may be, and almost surely are, socially preferable to some alternative allocations which satisfy the Pareto criteria. The political process possibly reflects social preferences in this regard more adequately than do market processes. The public choice literature implicitly rejects these politically-made decisions about distribution. It therefore implicitly presumes either that society does not have meaningful preferences about distribution, an assertion with which many political actors and voters would disagree, or that the distributional outcomes produced by the political system are less preferred socially than the existing distribution, an assertion which may be true but which is both unprovable and irrefutable. See ANTHONY B. ATKINSON & JOSEPH E. STIGLITZ, LECTURES ON PUBLIC ECONOMICS 336-43 (1980). As a result, a policy may be deemed undesirable in the public choice literature either if it alters the existing income distribution or involves some loss of efficiency in resource allocation, or both. This conclusion relies on

surely often be wrong. As numerous observers have noted,²² an interest group will almost always support a program by which it benefits; furthermore, one cannot attribute the passage of the legislation to the interest group's support without confusing correlation and causation. As to the second possible explanation for this pattern, the distributional characteristics of policies will generally be related to social welfare in unpredictable ways. A group's self-interest sometimes will coincide with the public interest, and sometimes contradict it.²³ No general conclusion seems possible.

Indeed, the deregulatory movement itself—a movement which in large part originated in the public choice logic²⁴—provides evidence that government may act in the general interest. After all, why should the logic of deregulation differ from the logic which explains regulation?²⁵ Why, then, do deregulatory movements succeed, if special interest groups oppose them? Either the successes of the deregulatory movement indicate that some public-regarding political outcomes succeed for reasons not explained by the model,²⁶ or that the political environment must have changed so that *deregulation* now serves the same private interests which once sought regulation.²⁷ And if this is so, self-serving behavior on occasion coincides with the public interest. The success of the deregu-

an assumption about the nature of the social welfare function, and cannot be logically derived.

However, in deference to what seems to be standard practice, I shall use the term "the public interest" in this Article to mean Pareto efficiency defined in terms of the existing income distribution, ignoring all problems arising from "Second-Best" theory. See *infra* note 29 and accompanying text.

²² See, e.g., Kalt & Zupan, *supra* note 1; Jerry L. Mashaw & David L. Harfst, *Regulation and Legal Culture: The Case of Motor Vehicle Safety*, 4 YALE J. ON REG. 257, 271 (1987).

²³ Commentators often justify the results by asserting that the regulatory policy in fact is unrelated to its stated goal and works an (intended but unjustifiable) transfer of income. In principle, the same concerns should apply to the removal of regulation, and even to the failure of the government to regulate. Again, a logically necessary step—some specification of a desired income distribution—is missing.

²⁴ See *supra* notes 5-8 and accompanying text.

²⁵ Kelman emphasizes that the elimination of governmental programs which former President Reagan attempted to achieve was often opposed by the special interests that benefitted from the individual programs, and "[o]ften only the diffuse interest of taxpayers in general stood on the other side." Steven Kelman, "Public Choice" and Public Spirit 87 THE PUBLIC INTEREST 80, 87 (1987). Yet such deregulation succeeded to some degree.

²⁶ Kalt and Zupan find that public-regarding motives are an important part of the explanation of regulatory legislation. Kalt & Zupan, *supra* note 1, at 279; see also BERNARD ASBELL, THE SENATE NOBODY KNOWS (1978); Kelman, *supra* note 25.

²⁷ Cass, for example, has suggested that deregulation may be explained in terms of changing conditions that reduce the benefits of regulation or that increase the costs of maintaining it. In particular, Cass suggests that deregulation resulted from technological developments that made competitive entry into regulated industries easier (thereby breaking down the cartel which supported and maintained the regulation), cartel breakdown for other reasons, and reduced information costs to non-cartel members concern-

latory movement demonstrates the limits of the model in prescribing policy.

For this reason, schemes designed to obstruct the power of government to adopt regulation, or which institutionally favor deregulation, risk serious error. Barriers to government action would bias the political process to favor groups which benefit from an absence of regulation, regardless of the public interest in that regulation. Furthermore, those barriers might screen out legislation which serves the public interest.²⁸ To impose barriers to government action biases the political process against governmental solutions, even when such solutions are appropriate. Whether unwarranted non-regulation is more or less a substantial concern than unwarranted regulation is purely an empirical matter.²⁹

The question raised by such considerations is whether proposals which would hinder the enactment of special interest legislation are the only possible institutional innovations to counter the problem of special interest politics.³⁰ Obviously, they are not. It may also be possible to limit the influence of interest groups on politics generally, and thereby simultaneously make it more likely that public-regarding legislation is adopted while private-regarding legislation is not. If the harm caused by the failure to enact public-regarding legislation exceeds the incremental costs of designing and implementing such unbiased proposals, then we should pursue those possibilities. The political logic of public choice would appear more appropriately to justify actions which discourage the involvement of special interest groups in the affairs of the public, or which handicap their normal political advantages, such as laws setting ethical standards for public officials or limiting the contributions of in-

ing the costs and benefits of regulation. Ronald A. Cass, *Privatization: Politics, Law, and Theory*, 71 MARQ. L. REV. 449, 476 n.140 (1988).

²⁸ For arguments that regulation may serve public welfare by enhancing economic efficiency, see WILLIAM J. BAUMOL, *WELFARE, ECONOMICS, AND THE THEORY OF THE STATE* (2d ed. 1965); ROBIN W. BOADWAY, *PUBLIC SECTOR ECONOMICS* (1979); ARTHUR CECIL PIGOU, *THE ECONOMICS OF WELFARE* (4th ed. 1932).

²⁹ In an important sense, the empirical question is unanswerable: a consequence of the Theory of the Second Best, which implies that the efficiency effects of a change in policy must be assessed in light of every other distortion present in the system, a problem which renders empirical welfare economics intractable. See Jagdish Bhagwati, *The Generalized Theory of Distortions and Welfare*, in *TRADE, BALANCE OF PAYMENTS AND GROWTH: ESSAYS IN HONOR OF CHARLES P. KINDLEBERGER* 69-90 (J. Bhagwati ed. 1971). Though the proposed institutional innovations depend on an empirical comparison, that comparison has not been undertaken. Yet if we cannot measure the empirical effects, perhaps we should not presume the direction in which particular policies move the national welfare.

³⁰ See Epstein, *Contract Clause*, *supra* note 10, at 718, for an argument that such proposals are necessary because they minimize the sum of costs arising from errors in institutional design, excessive government being more likely than insufficient government.

terest groups to political campaigns, than it justifies the current crop of institutional proposals.

In the remainder of this Article, I first explore the compatibility of public choice theory with legislative inaction and deregulation. I then examine the reasons why public choice theorists have chosen not to pay significant attention to this aspect of the interest group problem, and conclude that solutions which ignore the problem have the cost of exacerbating it. Finally, I argue that erecting barriers to government action because of concern about interest group politics is a serious error, and that such concern is more aptly addressed by solutions directed at interest group politics generally.

II

The economic theory of politics attempts to understand the nature of government in terms of the costs and benefits facing individuals affected by government action. Because political behavior quintessentially concerns group interests, this theory focuses on the relationships among individuals who share common economic interests and who are thus affected by their environment as a group, and on the relationships among such groups as they compete through the political process. The central inquiry is whether identity as a group alters the behavior of individuals within the group, and whether the characteristics of the group affect its ability to act on behalf of its members.

Public choice theory understands legislative outcomes to result from the supply and demand for political outcomes. The interests of competing groups may be affected, positively or negatively, by actions of the government. The government is the monopoly supplier of those outcomes which, because of legal constraints, cannot be privately supplied.³¹ Individuals are presumably willing to pay a positive price for governmental outcomes which benefit them; other individuals, with conflicting interests, are willing to pay for opposite results.³² The theory assumes that legislators (or the representa-

³¹ Stigler has listed four "commodities" which the state may provide to an industry. G. STIGLER, *supra* note 1, at 115-19. The first is a direct subsidy, an overt transfer payment to members of the industry. Stigler notes that this will simply induce entry into the industry, resulting in dissipation of the subsidy among the new entrants, thus making it an unattractive proposal to the existing industry members. Second, the state may limit entry into the industry by new rivals. The result would be cartelization of an industry, a violation of the Sherman Antitrust Act if performed by members of the industry, but usually permissible regulation if performed by the government. *See* Parker v. Brown, 317 U.S. 341 (1943). A third possible commodity which may be supplied by government to the winning bidder are controls over products which substitute for or complement the bidder's own product in consumption. A fourth is price fixing.

³² Such a price may consist of lobbying costs, contributions, reciprocal support on other issues, or in similar currency. The group must not only mobilize its own vote; it

tives of other repositories of government power)³³ are willing to supply legislative results to the highest effective bidder.³⁴ It is therefore essential to the model that one interest group may seek governmental inaction just as vigorously as an opposing interest group may seek governmental action. The presumed legislative outcome is the result of an implicit (or explicit) contract between the supplier-legislator and the group which offers the highest effective price.³⁵ The bulk of public choice theory consists of speculation as to how effectively competing groups can collectively express the

must also contribute to the appropriate political party to finance campaigns, to persuade other voters, possibly to bribe officeholders. See Peltzman, *supra* note 1, at 213.

³³ Though all branches of government are, in principle, available for hire in terms of currency relevant to their interests, legislators are presumed to be especially vulnerable to this logic. Judges, by constitutional limit, are uninterested in political support or contributions, and by assumption averse to overt bribes. The interests of the executive are sufficiently diverse, at least at the federal level, to be beyond reach of any single interest group. "Bureaucrats," a uniquely slothful species, favor their client industry largely to avoid being bothered by courts and lobbying groups who would otherwise disturb their repose.

³⁴ Peltzman, *supra* note 1, at 211.

³⁵ Public choice theorists would not have us dwell on the plausibility or empirical basis of this view of political behavior. After all, the positive methods of economics, which view the verifiability of its implications as the crucial test of a theory, are indifferent to the possibility of documenting such transactions. Milton Friedman, *The Methodology of Positive Economics*, in *ESSAYS IN POSITIVE ECONOMICS* 3 (1953). Indeed, I am aware of no empirical work which attempts to provide evidence of actual legislative bribes.

Consequently, if the effects of legislation benefit a group whose characteristics lead one to presume political effectiveness, then the theory allows us to presume that some transaction analogous to a bribe has occurred, though the "bribe" may violate no law. As Stigler argues, "the announced goals of a policy are sometimes unrelated or perversely related to its actual effects, and the *truly intended effects should be deduced from the actual effects.*" G. STIGLER, *supra* note 1, at 140 (emphasis in original). This argument has been crucial to the empirical work performed under the banner of public choice theory, since that work has focused on the effects of the legislation while ignoring actual observation of the alleged deals. For example, Pashigian states:

The federal government's role in the regulation of environmental conditions is not completely clear: many economists would argue that it is to correct interstate and regional externalities caused by the mobility of airborne emissions and water discharges. This assessment is widely shared but may have been reached somewhat prematurely. The effects of environmental regulation are scarcely known, and no comprehensive assessment can be contemplated at this stage. While the legislation clearly focuses on the need for an improvement in public health, experience with other government regulatory programs suggests the stated goals and the actual effects are not one and the same. The enforcement of regulations often has effects not readily apparent from a reading of the legislation. An essential first step in the process of understanding the reasons for environmental regulation is a careful catalog of the actual effects of environmental regulation.

Pashigian, *supra* note 4, at 1. As Mashaw and Harfst have noted, however, some group will always benefit from any action, and that group is likely to support that action. Mashaw & Harfst, *supra* note 22, at 271. The relevance of this form of empirical support therefore appears questionable. Correlation does not necessarily imply causation.

demands of their individual members for legislative results.³⁶

The success of a group in outbidding competing interest groups and achieving legislative success depends largely on the total level of aggregated demand in the group for a particular legislative result and on the ability of the group to manifest that demand in an effective bribe to the legislator. The latter, in turn, is determined by the costs the group encounters in achieving collective ends. Group interactions, in general, will not be costless. The size of the bribe is, from the viewpoint of members of the group, a public good.³⁷ A winning bribe benefits all the group members; the identity of actual contributors is irrelevant. Each member prefers to let other members actually contribute the cost of the bribe, since that member will benefit equally regardless of the size of his own contribution. Furthermore, each individual will have an incentive to hide the actual size of his benefit from his fellow group members, since by doing so he may be able to reduce the size of the contribution the group demands. Thus groups are inevitably subject to transactions costs and information costs.

The amount of these costs will vary directly with the size of the group.³⁸ The smaller the group, the more likely it is that an individual group member will prefer to bear the cost of the action rather than risk its not occurring. Since that individual, however, by assumption seeks to benefit only himself and does not care about the welfare of group members, he will seek to ensure that others pay for the goods the group collectively consumes. The larger the group, the less likely it is that the individual will be willing to pay for the group's consumption, and the greater is the individual's incentive to try to pass the cost to other group members. Larger groups will therefore encounter more difficulty organizing and securing the desired good (in this case, contributions to the bribe fund) for its members. Smaller groups will more effectively manifest the demand of their members for legislative actions. Larger groups, particularly those as large as the "general public," will be most subject to these free-rider problems, and may be entirely unable to make effective bribe offers to legislators. Their chief form of political strength will

³⁶ See M. OLSON, *supra* note 3, at 33-36.

³⁷ *Id.* at 9-16.

³⁸ *Id.* at 28. Smallness is not the only criterion of political effectiveness in this model. Homogeneity of interests, asymmetry of group membership size, geographic dispersion of members, and so on, may also affect the ability of group members to make offers to legislators. As with size, there is no obvious reason—and certainly none within the confines of the model itself—that groups with varying degrees of those characteristics will consistently prefer any predictable political agenda. Groups will pursue those political goals which serve the unique interests of the particular group, instead of sharing a common political agenda with all groups of a given size, homogeneity, and so on. *Id.* at 33-36.

come, not through this political marketplace, but through their superior voting power in elections. However, since no member of the group may benefit sufficiently to bear the costs of learning the politics of a particular issue, even that form of political action may be problematic. Therefore, the conclusion that the dynamics of this process will favor any particular legislative agenda requires an assumption that smaller groups will necessarily favor that agenda, while larger groups will consistently and predictably oppose that agenda.

If there were none of the free rider costs described above, all legislation would be Pareto-improving. Each group could offer the legislature (nearly) the full surplus value of the aggregate benefit to its members. The group with the highest bid would also be the group seeking the socially highest-valued legislative outcome. The presence of such costs, however, implies that bribes will not fully reflect group values. Small groups may be able to outbid larger groups even when their aggregate benefit is less than that of the larger group. Hence, actual legislative outcomes may predictably differ from the optimal.³⁹

III

As this discussion indicates, nothing restricts the application of this theory of politics to positive acts of legislation. On the contrary, the model takes explicit account of the conflicting interests of groups. If Group A benefits from a legislative act, while Group B is harmed by it, the actual outcome will depend on the size of the competing bribes. Members of Group B will have an incentive to fight the proposed action. The defeat of the proposed action does not necessarily reflect the influence of "special interests" less than its victory. The economic model of regulation presumes a perfect symmetry of logic between the successful implementation of legislation benefitting the group and the successful defeat of legislation harming the group.

This means we can reverse the conventional political conclusions of the economic theory of regulation while doing no injury to the theory itself. Cases will almost surely exist in which the benefits and costs of regulation follow a pattern the opposite of that conventionally supposed. Rather than the costs of a regulatory scheme being widely spread across a large and politically diffuse "public," while benefits of the regulation fall on a coherent and small group, the opposite pattern will sometimes prevail. If at times a small lob-

³⁹ The only definition of optimality used here is that of Pareto optimality, a definition that is entirely utilitarian and individualistic. Other views of the socially desirable may or may not be better served by the special-interest logic.

bying group will successfully impose a self-serving regulatory program on the public, it is also possible that a small group might successfully oppose a regulatory scheme which the public at large would favor. There is no reason, then, to presume *a priori* that the failure of the government to intervene in some aspect of the economy represents the defeat of a special interest group. On the contrary, special interest groups have much to fear from an activist government, and surely organize to oppose government action.⁴⁰ Indeed, opposition to government actions which harm the group will often be a more productive investment of lobbying dollars than is support for actions which help the group. The courts in general hold administrative agencies to a far lower standard of judicial review when agencies fail to act than when they do affirmatively act.⁴¹ Opposition to actions which may harm the group may therefore have a larger realized payoff than equivalent resources devoted to the advocacy of positive actions which, if enacted, may eventually be reviewed by a skeptical court.⁴² As a result, special interest opposition to affirmative actions of government may be a more common focus of lobbying activity than has been generally recognized.

Nevertheless, the attention devoted to such possibilities in the public choice literature has been minimal. The literature has viewed the opposition of interest groups to public-regarding governmental action as enhancing the case for new barriers to government action: since legislation is unlikely to be enacted if it is public-regarding, obstacles to government action have little cost.⁴³ This conclusion, however, is wrong. Barriers to government action inevitably will deter not only special interest legislation, but all government action of whatever character; the difficulties already facing public-regarding legislation surely speak against imposing additional barriers. More importantly, the real basis for that conclusion is an unarticulated but

⁴⁰ Concern for the exploitation of minority groups by more powerful majorities, often voiced in the public choice literature, is one expression of these fears. See, e.g., George J. Stigler, *Director's Law of Public Income Redistribution*, 13 J.L. & ECON. 1 (1970).

⁴¹ See *Heckler v. Chaney*, 470 U.S. 821 (1985); *ITT World Communications, Inc. v. FCC*, 699 F.2d 1219, 1245-46 (D.C. Cir. 1983); *Rockford League of Women Voters v. Nuclear Regulatory Comm'n.*, 679 F.2d 1218, 1222 (7th Cir. 1982); *Environmental Defense Fund, Inc. v. Costle*, 657 F.2d 275, 283-84 (D.C. Cir. 1981); *WWHT v. FCC*, 656 F.2d 807, 809, 817-18 (D.C. Cir. 1981).

⁴² The courts have applied a more deferential standard of review to agency inaction than they have to overt agency action (including actions which remove existing regulations). Because there is no record explaining the failure to act, and because the reasons for inaction are potentially so diverse, inaction has been deemed ill suited to judicial review. See *Natural Resources Defense Council v. Securities and Exch. Comm'n.*, 606 F.2d 1031, 1046, 1052-53 (D.C. Cir. 1979); Garland, *supra* note 8, at 516.

⁴³ PETER H. ARANSON, *AMERICAN GOVERNMENT: STRATEGY AND CHOICE* 79-82 (1981); MANCUR OLSON, *THE RISE AND DECLINE OF NATIONS* 41-47 (1982); Aranson, Gellhorn & Robinson, *supra* note 9, at 31 n.133; Macey, *supra* note 11, at 231.

crucial assumption: that government inaction is acceptable because action is generally unnecessary, that government has little valid role to play. If barriers to government action force us to forego the benefits that government can bestow, those lost benefits are insignificant.⁴⁴ This conclusion, of course, does not follow from public choice theory; indeed, as I shall show below, public choice theory renders it implausible.

Fundamentally, the decision to design generalized barriers against government results from a simple logical error. We need not show that the costs of private market inefficiency are large in an absolute sense to justify concern about them. We need only show that private inefficiency is sufficient to outweigh the costs of designing relatively unbiased institutional remedies, in place of the biased remedies which have appeared in the public choice literature to date. The case has not been made that only biased remedies are feasible.⁴⁵ The question whether substantial inefficiency exists in private markets is, of course, empirical. In general, the difficulties of measuring private market inefficiency are such that its size remains largely unexplored.⁴⁶ The contention that such inefficiencies are small might be correct.⁴⁷ Nevertheless, that contention cannot justify the policy conclusions that have been reached. At the same time, the empirical importance of unjustifiable government inaction simply has not been investigated, and thus has been implicitly minimized.⁴⁸

⁴⁴ See, e.g., Epstein, *Contract Clause*, *supra* note 10, at 718.

⁴⁵ These proposals reach beyond solving only one part of the general problem of special interest influence, leaving until later the perhaps more difficult problem of ensuring that a special interest system of government will not foster inappropriate inaction. Rather, many of these proposals are explicitly designed to work in one direction only. An example is Epstein's proposal that the Contract Clause be used to bar governmental actions which disturb privileges existing under the common law. His proposal is designed to minimize legislative interference with the common law understanding of private contract, treating legislative inaction as a protected norm. See *id.* at 748.

⁴⁶ See ALLEN V. KNEESE, *MEASURING THE BENEFITS OF CLEAN AIR AND WATER* (1984).

⁴⁷ This assessment is widely shared among writers in the public choice tradition. Nevertheless, what is known in the economic literature as the Theory of the Second Best renders it effectively impossible to measure the inefficiency associated with any policy position; the actual inefficiency of private markets is empirically unknowable, either absolutely or relative to the alternative. See *supra* note 29.

⁴⁸ The conclusion that the positive actions of government empirically are of little importance is often simply taken as a matter of faith. See, for example, Aranson, Gellhorn & Robinson, *supra* note 9, at 37:

It is dismally true that the reality of collective action has little to do with welfare theory. The theoretical principles of welfare theory . . . bear little resemblance to the kinds of collective action actually taken. To review examples of the divergence between the normative theories of collective action and the political reality would be a tedious exercise. Suffice it simply to assert what ordinary observation will show: the "public goods" that Congress actually supplies seldom conform to those that

Epstein, for example, argues that the Constitution was originally structured to create this very imbalance.⁴⁹ To eliminate the problem of "faction," Epstein asserts, the Framers enacted a system of checks and balances "whose major function was to place procedural obstacles in the path of legislation."⁵⁰ As a consequence, he suggests that courts use the Contract Clause⁵¹ to limit the ability of government to disturb the property relationships defined in the common law.⁵² Though he recognizes that "legislative efforts to tax or regulate will be resisted by the private parties they hurt,"⁵³ he concludes that such logic "lend[s] force to the view, evident in both the framers' general theory and the text they drafted, that government power must be curbed,"⁵⁴ without addressing the implication that unregulated markets may be unregulated for reasons of private, and not public, interest. Epstein thus implicitly assumes that the Framers were unconcerned with the ability of factions to impede the adoption of desirable legislation.

Similarly, McChesney argues that legislators frequently use the threat of regulation as a device to extract rent from private parties eager to avoid regulation of their industry.⁵⁵ He concludes that the government's power to regulate should be limited precisely to prevent such rent-extraction.⁵⁶ The argument, however, fails to recognize the possibility that the absence of regulation may also be sought by private parties as a private good which may conflict with

classical welfare justifications define; externalities and market imperfections are as often the consequences as they are the causes of government intervention; redistribution programs all too often shift wealth from the poor to the (relatively) affluent.

⁴⁹ Epstein, *Contract Clause*, *supra* note 10.

⁵⁰ *Id.* at 715.

⁵¹ "No State shall enter into any . . . Law impairing the Obligation of Contracts. . . ." U.S. CONST. art. I, § 10, cl. 1.

⁵² Epstein urges that the Contract Clause be used to bar changes in state law which would apply even to contracts as yet unformed. Epstein, *Contract Clause*, *supra* note 10, at 723-30. He argues that the test for whether a state should be barred from any particular change in law is the extent to which the *possibility* of such a law might generate rent-seeking behavior by parties seeking or opposing the law. Yet forbidding even prospective alterations of as-yet-unformed contracts obviously prevents the states from correcting errors in state law. Epstein does not address the question of how evolutionary changes in state common law might be affected by his proposal, nor whether similar considerations ought to apply to judge-made law. This construction of the Contract Clause neglects the costs associated with such errors. Furthermore, his idea that this would somehow free contract terms of the problem of faction is misleading; it neglects the interest of some factions in preserving state contract law as it stands, and the relevance of the problem of faction to the legal process itself.

⁵³ *Id.* at 713.

⁵⁴ *Id.* at 715. Indeed, he argues, "[g]iven the persistence of rent-seeking and self-interest, the only way to prevent all excesses is to eliminate all government." *Id.*

⁵⁵ Fred S. McChesney, *Rent Extraction and Rent Creation in the Economic Theory of Regulation*, 16 J. LEGAL STUD. 101 (1987).

⁵⁶ *Id.* at 102-03.

the public interest. As a result, his proposal would prevent essentially socially costless transfers of resources from private parties to legislators, at the cost of ensuring that those private parties will achieve their goals of being unregulated, even when non-regulation involves a social loss to the public.

By posing new barriers to government action while leaving undisturbed the ability of government not to act, these proposals would have the implicit effect of promoting inaction. Simply as a matter of randomness, these proposals will promote less government action: the probability that legislative initiatives will succeed is lowered, automatically raising the odds that government will fail to act. But the effects in fact go beyond that. An interest group with lobbying dollars to invest in influencing government will be led, by such measures, to invest those dollars in opposing government actions which harm the group, rather than in promoting government actions which help it. This is simply a consequence of the economic law that demand curves are negatively sloped:⁵⁷ the probability of success in opposing government action has been raised, and the probability of success in seeking new favors has been lowered. Opposition to action therefore will be a relatively more certain investment than it is now. Proposals such as these do not simply raise the cost of taking government action; they divert lobbying dollars from the advocacy of rent-enhancing government action to rent-preserving government inaction. The proposals do not merely solve a part of the special interest problem, leaving the more difficult problem of inaction until later; they reduce the likelihood that desirable legislation will be enacted. They therefore promote the public interest in one direction, but work against the public interest in the other.

IV

Though the special interest logic naturally raises concerns that government may fail to regulate when it should, public choice scholars have devoted their attention largely to the opposite problem. The explanation of this paradox lies not in the special interest logic itself, but elsewhere.⁵⁸

⁵⁷ See GARY S. BECKER, *ECONOMIC THEORY* 42 (1971).

⁵⁸ In important part, of course, the explanation lies in the remarkably narrow and inadequate description of the motivations of persons working in the public sector which public choice writers seem consistently to provide. Anthony Downs, for example, assumed that politicians "act solely in order to attain the income, prestige, and power which come from being in office." ANTHONY DOWNS, *AN ECONOMIC THEORY OF DEMOCRACY* 28 (1957). Niskanen explained that bureaucrats are "budget maximizers." WILLIAM NISKANEN, *BUREAUCRACY AND REPRESENTATIVE GOVERNMENT* (1971). David Mayhew saw Congressmen as "single-minded reelection seekers." DAVID M. HEW,

In particular, the explanation lies in a belief that only politics, of the major systems for making social decisions, contains fundamental and consistent flaws stemming from imbalances in interest group power. The available alternative systems for reaching these decisions are, first, the common law, in which judges insulated from political pressures and self-interest incrementally derive legal rules constantly tested by an ongoing flow of litigation; and second, the market, in which the Smithian logic of the invisible hand leads (in the appropriate circumstances) to the "best" possible resource allocation.⁵⁹ If the alternatives, either separately or together, can reliably produce consistently desirable results, then posing new obstacles to the enactment of legislation should be no cause for concern. The opportunities for public-regarding legislation are so minimal—and the opportunity for special-interest legislation so breathtaking—that one scarcely need be concerned if the former is prevented along with the latter.

If the system of "private law," combined with private markets, really does define an ideal set of rights and obligations, then simply preventing governmental action is sufficient. Interest groups themselves will successfully resist reductions in their wealth resulting from governmental action; only their efforts to increase their wealth must be resisted by the design of governmental institutions capable of resisting their pressures. The assumed reliability of market- and

CONGRESS: THE ELECTORAL CONNECTION 17 (1974). Such assumptions, of course, may have been adopted simply to facilitate building a coherent model of manageable complexity; however, the conclusion that bureaucrats and politicians willingly forego the public interest to achieve their private ends is surely in part an artifact of the initial assumptions. It is as if economists assumed at the outset that firms maximize profits, and concluded that all capitalists must be monstrous cutthroats and thieves.

In fact, persuasive empirical evidence shows that "altruistic, publicly interested goals" may motivate public actors in large part and that "a view of political actors as narrowly egocentric maximizers explain[s] and predict[s] legislative outcomes poorly." Kalt & Zupan, *supra* note 1, at 279. See also B. ASBELL, *supra* note 26; CONGRESS OFF THE RECORD (J. Bibby ed. 1983); JOSEPH E. KALT, THE ECONOMICS AND POLITICS OF OIL PRICE REGULATION (1981); James B. Kau & Paul H. Rubin, *Self-Interest, Ideology and Log-rolling in Congressional Voting*, 22 J.L. & ECON. 365 (1979); S. Peltzman, *Constituent Interest and Congressional Voting*, (Feb. 1982) (unpublished manuscript, University of Chicago Economic and Legal Organization Workshop).

⁵⁹ These two, of course, are not distinct. The market operates only in the context of the rights defined by law, as economists have long recognized. See Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. PAPERS & PROC. 347 (1967). But together they constitute what may be considered a "private" allocation system, in contrast to the "public" schemes involving legislative action:

Monopoly, pollution, fraud, mistake, mismanagement, and other unhappy by-products of the market are conventionally viewed as failures of the market's self-regulatory mechanisms and therefore as appropriate occasions for public regulation. But this way of looking at the matter is misleading. The failure is ordinarily a failure of the market *and* of the rules of the market prescribed by the common law.

RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 343 (1986).

common-law outcomes minimizes the danger posed by theoretically biased political rules.

If the "private law" definition of legal rights and obligations is *not* reliably optimal, however, then such biased rules can become the source of serious distortions.⁶⁰ If the common law has granted some group an efficiency-distorting favor, then legislative means must at times be relied upon to reduce those rights.⁶¹ Institutions that not only resist "incorrect" changes in legal rights, but that also hinder "correct" changes, are intrinsically inadequate. Conversely, if the common law placed efficiency-reducing burdens on a group, and market transactions could not overcome those burdens because transactions were prohibitively costly, then the group's efforts to enhance its welfare by seeking "special interest" legislation should not meet with exceptional obstacles.⁶²

In short, government may enhance social welfare if social decision mechanisms that are usually thought of as "non-governmental" cannot be relied upon to achieve socially correct results. On the other hand, if those mechanisms are reliable, then obviously there is little need for politics; restraints on governmental action⁶³ will ade-

⁶⁰ There is, of course, a problem arising from general equilibrium theory. Once even a single distortion exists in equilibrium, adding a second distortion may or may not bring us closer to the Pareto optimum, depending on the average rate of distortion in the economy and the degree of substitutability between the goods subject to the original distortion and the goods to be subject to the new distortion. If there are multiple distortions in the economy, the optimality properties of any new distortion become rapidly beyond calculation. Thus, in a fundamental sense, all empirical welfare economics is impossible. As is the custom in discussing the efficiency effects of distortions, we shall blithely ignore this problem.

⁶¹ The Coase theorem tells us that excessive allocations of rights are not a problem for market efficiency because those rights can be "bought" by the politically disfavored group. Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & Econ. 1 (1960). Applying that argument, Calabresi has observed that any distortion of efficiency can be circumvented by market processes. Guido Calabresi, *Transaction Costs, Resource Allocation and Liability Rules—A Comment*, 11 J.L. & Econ. 67 (1968). While that answer suffices for market failures which would occur but for the absence of transactions costs, it does not suffice when legislative action has rendered unattainable certain market outcomes such as child labor or slavery, or for market transactions in the presence of transactions costs. There is no reason to suppose that legislated legal restraints can effectively rule out relevant market outcomes while judicial action cannot.

⁶² Perhaps interest groups have little incentive to promote their own welfare by seeking to improve the welfare of society as a whole. M. OLSON, *supra* note 43, at 41-47. Nevertheless, there will inevitably be times when a group's private interest will coincide with the interests of the public. Though the group may care little about its impact on the public, it will enhance the public welfare by seeking its own. The classic example, of course, is private economic activity, in which self-interested economic actors are led, "as if by an invisible hand, to seek an end which was no part of their intention." ADAM SMITH, *THE WEALTH OF NATIONS* (A. Skinner 7th ed. 1979).

⁶³ In such a case, politics becomes analogous, not to voluntary exchange, but to theft. In the case of normal economic activity, desirable constraints against theft and compulsion would be present. In the case of political activity, change-reducing con-

quately protect the public interest from private political power. For this reason, the case against governmental action on public choice grounds has as its necessary correlate the proposition that failures of private economic markets will be few, and that failures of the market can and will be appropriately corrected by the common law.

In fact, however, public choice theory raises concerns about the neutrality of private markets and the common law which are no less severe than those relating to political action, and for much the same reasons. If we accept that organizationally effective groups can influence political outcomes, we must accept the possibility that those groups may also influence non-political outcomes.

A.

In fact, of course, a case for the optimality of the common law has been made,⁶⁴ and its weaknesses vigorously argued.⁶⁵ At a minimum, the argument draws static conclusions from an inherently dynamic process: at best the common law tends in the direction of optimality, and one can never be sure when optimality has actually been reached. It is possible that the relevant parameters have been stable long enough for these tendencies to render the common law system optimal, but that conclusion is at best speculative and counterintuitive: changes in the underlying economy generate changes in optimal rules. Judicial understanding of which rules are "optimal" may change over time as evidenced by recent theorizing about tort liability doctrine.⁶⁶ And differing outcomes in different jurisdictions present obvious demands for explanation.

To take a well-known example, the common law doctrine of tort privity insulated nineteenth-century manufacturers from product liability when they lacked a direct contractual relationship with their product's ultimate consumer. That doctrine limited the ability of tort law to impose the full costs of unsafe products on the manufacturer, and thus to ensure that manufacturers would invest optimally in safety.⁶⁷ Judicial abrogation of the privity doctrine ultimately cor-

straints could be of any form that limit the ability of the political system to act. This is the goal of the proposals discussed earlier in this Article.

⁶⁴ Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974); William M. Landes & Richard A. Posner, *The Independent Judiciary in an Interest Group Perspective*, 18 J.L. & ECON. 875 (1975); William Landes & Richard A. Posner, *Legal Precedent: A Theoretical and Empirical Analysis*, 19 J.L. & ECON. 249 (1976).

⁶⁵ See, e.g., John A. Siliciano, *Corporate Behavior and the Social Efficiency of Tort Law*, 85 MICH. L. REV. 1820 (1987).

⁶⁶ Compare, e.g., GUIDO CALABRESI, *THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS* (1970) with PETER W. HUBER, *LIABILITY: THE LEGAL REVOLUTION AND ITS CONSEQUENCES* (1988).

⁶⁷ Siliciano, *supra* note 65, at 1827.

rected this market distortion,⁶⁸ but prior to abrogation the law served the interests of some of its more persistent and well-organized litigants. Manufacturing interests undoubtedly were well represented in nineteenth-century courts.⁶⁹

The example, however, is suggestive. The special interest logic depends on the proposition that certain groups have characteristics which give them relative advantages. There is little reason to expect those advantages to cease at the boundaries of the political system. Posner has argued that evolutionary systems within the common law ensure its tendency towards optimality:

An inefficient rule, by definition, imposes larger costs on society than an efficient one. This might seem to create incentives to litigate inefficient rules more, until the courts make them efficient. . . . [C]ompare two rules, one of which leads to twice as many accidents as the other with no offsetting reduction in the cost of safety measures. The inefficient rule will lead to more litigation than the efficient rule, and thus give the courts more opportunity to reexamine it. Suppose that, just by chance, the courts in the course of this reexamination hit on the efficient result. The number of accidents will fall; the rate of litigation will fall; and the courts will be less likely to reexamine the rule in the future.⁷⁰

But the understanding of group processes which underlies public choice theory leads to a different result. Legal rules in fact will be reexamined when some group or individual has the incentive and ability to bring the matter to the attention of the courts. Organizationally efficient groups have greater ability to sustain continued assaults on legal rules they dislike than do less efficient groups. In short, a rule will be reexamined more often if it harms the interests of efficient groups, and will be reexamined less often if it harms the interests only of less efficient groups. Distributionally vulnerable rules, not inefficient rules, are the more likely to be overturned.

In the legal context, the advantages of organizationally efficient groups are no less than their advantages in political action. Whether pooling funds to finance legal battles through trade as-

⁶⁸ See William L. Prosser, *The Assault upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099 (1960); see also William Landes & Richard A. Posner, *A Positive Economic Analysis of Products Liability*, 14 J. LEGAL STUD. 535, 547-49 (1985).

⁶⁹ This argument has been made by MORTON HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW, 1780-1860* (1977); Grant Gilmore, *Products Liability: A Commentary*, 38 U. CHI. L. REV. 103 (1970); Gary Schwartz, *Tort Law and the Economy in Nineteenth Century America: A Reinterpretation*, 90 YALE L.J. 1717 (1981).

⁷⁰ R. POSNER, *supra* note 59, at 527-29. For similar arguments, see William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235 (1979); George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65 (1977); Paul Rubin, *Why Is the Common Law Efficient?* 6 J. LEGAL STUD. 51 (1977).

sociations, or adopting a joint litigation strategy to press a common viewpoint, they will have incentives to pool resources more successfully than their opponents: after all, they are the very groups able to pool resources successfully in the political context. Since such groups tend to be smaller than their opponents, a successful outcome in litigation is more valuable as a private good to the members of such groups than it would be for any one of their more numerous opponents. Each member will capture a larger share of the returns from the establishment of a favorable rule than their opponents.

Not only are the costs of achieving group-serving litigational goals relatively low for these groups, but the incentives to pursue such an agenda are often relatively great. Calabresi has demonstrated⁷¹ that to achieve economically efficient rules with respect to involuntary interactions, liability should in general be placed on the party with the lowest costs of avoiding the litigation-generating event.⁷² Yet such costs are not inherently different from the costs that define political effectiveness in the public-choice model. Both fundamentally involve the ability to minimize transactions costs, whether in terms of political action or of market action. It is generally the groups with lower litigation costs that also have the greatest incentive to litigate: it is they who, absent resistance, will be most consistently saddled with liability under Calabresi-style common law rules.

To the extent parties affected by common law rulemaking can alter the rules derived through the court system to their advantage, they will attempt to do so. The fact that parties often are willing to pay quite substantial premiums for higher-quality legal services⁷³ indicates that higher-quality legal services have an incremental product, *i.e.*, are more likely to prevail than lower quality services.⁷⁴ The expenditure of resources is therefore likely to correlate, at least to some degree, with result. Groups better able to muster resources will succeed more frequently in establishing favorable legal rules

⁷¹ See G. CALABRESI, *supra* note 66.

⁷² *Id.*

⁷³ By higher-quality services, I mean simply legal services believed *a priori* by the client to be more likely to achieve a successful outcome.

⁷⁴ Prices of legal services vary substantially, yet higher-priced practitioners do not apparently lack business. Price variation is indicative of product differentiation and variation in quality. See RICHARD A. POSNER, *THE FEDERAL COURTS: CRISIS AND REFORM*, pts. I and II (1985); Arthur Denzau, *Litigation Expenditures as Private Determinants of Judicial Decisions: A Comment*, 8 J. LEGAL STUD. 295 (1979); Landes & Posner, *supra* note 70; Peter J. Menell, *A Note on Private Versus Social Incentives to Sue in a Costly Legal System*, 12 J. LEGAL STUD. 41 (1983); Richard A. Posner, *An Economic Approach to Legal Procedure and Judicial Administration*, 2 J. LEGAL STUD. 399 (1973); George L. Priest, *Regulating the Content and Volume of Litigation: An Economic Analysis*, 1 SUP. CT. ECON. REV. 163 (1982); Steven Shavell, *Suit, Settlement, and Trial: A Theoretical Analysis Under Alternative Methods for the Allocation of Legal Costs*, 11 J. LEGAL STUD. 55 (1982).

than groups less able to do so. Yet it is just this ability to muster resources, to act collectively as a group, that defines the groups likely to succeed in the political context.

If cohesive groups can structure common law rules to serve their interests, then they will have every incentive to resist changes in the common law that arise from political sources. Such groups will often assume the role of resisting political actions. Whenever their goals have already been achieved through the courts, politics represents a threat to gains already made.⁷⁵ Whether they will seek to preserve advantages gained through the legal system by resisting political change, or, alternatively, to achieve those advantages by political action and then preserve them by resisting legal challenges, will depend simply on the relative costs of those two courses of action. In many cases, it will surely be cheaper and more reliable to seek to establish common law rules, buttressed by *stare decisis*, than to rely on the shifting vagaries of politics. In any case, it seems impossible to predict which of those two routes will be chosen. Closing off one route by means of the anti-political approaches advocated by public choice writers will surely lead to an emphasis on the other. If the public choice reforms give institutional advantages to those interest groups resisting change arising via the political system, these groups will be better able to preserve the gains they secure through the courts.⁷⁶

The organizationally effective group, therefore, is likely to view the common law outcome, and potential change in that outcome through political activity, as alternatives; the choice between them will be determined by a belief as to which will yield the highest net present value. When regulation is not sought then it must be presumed to yield less net value to the group than alternative courses of action. The decision by an interest group not to seek regulation of its industry cannot be viewed as benign. The unregulated state, in which liability is determined by litigation and common law rules,

⁷⁵ It is, of course, possible that such groups may use the political system to ensure by statute that which the judicial system has already invented. An example is the system of limited liability for corporate shareholders, which originally arose in judicial doctrine and is now prescribed by statute in virtually all jurisdictions. See generally Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89 (1985); Paul Halpern, Michael Trebilock & Stuart Turnbull, *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117 (1980); Robert W. Hamilton, *The Corporate Entity*, 49 TEX. L. REV. 979 (1971).

⁷⁶ Obviously, if courts assign liability to the organizationally efficient group, then their best course of action is to overturn court action through legislation. If, on the other hand, the courts assign liability elsewhere, then political action will represent a threat to their courtroom successes. Indeed, one reason public choice theorists find so little legislation public-regarding may be that interest groups consistently oppose the passage of such legislation, possibly because they are favored under the common law. See *supra* note 20.

may be preferred by the politically effective group and is, in any case, itself the product of special interest logic.⁷⁷

Common law outcomes cannot, therefore, be used as a benchmark of optimality. If a special interest group is assigned liability, rightly or wrongly, that assignment will be resisted by subsequent litigation or legislative action; sometimes the former will be the lower cost strategy, sometimes the latter will be. Eliminating the option of legislative action will divert rent-seeking to the courts, where the same cost advantages that make such groups politically effective may also imply their litigational success. On the other hand, if liability is assigned elsewhere by the courts, the same forces imply that that outcome will not generally be altered legislatively and that litigational attacks will often be successfully resisted; proposals that impede legislative action will help to preserve those liability assignments. If affirmative governmental (*i.e.*, nonjudicial) action is biased because politics is biased, then *a fortiori* common law outcomes must also be biased, because the same forces that bias politics also affect legal outcomes.

B.

When, however, a transaction is entirely private, and depends neither on regulatory action nor on any particular judicial assignment of legal right, the opportunities for more effective groups to benefit from their strengths is at a minimum. The Coase theorem tells us that legal assignments of rights or liabilities are irrelevant to the efficiency of market solutions when transactions are costless.⁷⁸ Individual incentives ensure that all mutually beneficial transactions occur. As Calabresi demonstrated, traditional sources of alleged market failure simply present opportunities for mutually beneficial transactions which eliminate the inefficiency.⁷⁹ No government action can change an outcome arrived at in these circumstances without making at least one party worse off, and possibly both.

It is in this idealized world of zero transactions costs that the special interest model has typically been applied. Because markets can in this world circumvent any potential market failure, the role of government is necessarily limited. It may benefit interest groups to seek politically provided commodities⁸⁰ that reduce the welfare of their trading partners—in short, to use the state for purely coercive purposes, to force transactions on unwilling trading partners, or to

⁷⁷ See Denzau, *supra* note 74.

⁷⁸ Coase, *supra* note 61, at 101-04.

⁷⁹ Calabresi, *supra* note 61, at 70-73.

⁸⁰ See *supra* note 31.

alter the terms of transactions.⁸¹ In such circumstances, government action has least justification, and safeguards against its wrongful use are most attractive.

Absent those circumstances,⁸² however, the case breaks down. When transactions costs cannot be ignored,⁸³ the legal regime is no longer irrelevant.⁸⁴ Since the law cannot be relied upon to be free of special interest influence, and hence is not necessarily optimal, there can be no principled assurance that governmental solutions are not an improvement on the imperfect market.⁸⁵ Creating biases against the use of government runs the risk of forcing reliance on

⁸¹ This is the model implicitly assumed by standard public choice doctrine: that in the absence of government, markets would work optimally. See, e.g., Paul Rubin, DEREGULATION, REREGULATION, AND THE MYTH OF THE MARKET, (Boalt Hall School of Law, Program in Law and Economics Working Paper No. 88-8, 1988). Since members of the politically effective group could not in any case be forced into an economic transaction under normal market rules, additional government action to prevent coercion (and hence non-optimal transactions) is unnecessary. Government makes non-optimal transactions possible, in this view, but will never be necessary to prevent such transactions beyond normal police powers. Hence, barriers against additional government action are desirable: they foster more efficient markets. No price need be paid in terms of foregone governmental actions; such actions serve no purpose in any case, because the market handles such problems more efficiently.

⁸² Peltzman notes that the "public interest" model of regulation "comes perilously close to treating regulation as a free good." Peltzman, *supra* note 1, at 212. Failing to recognize the importance of transactions costs in private markets makes a comparable mistake about private transactions. As Farrell points out, the condition which renders the Coase theorem operative—the absence of private information—is not only implausible, it renders the decentralization result embodied in private markets irrelevant, since in these circumstances a centralized authority in principle could direct resources equally effectively. Joseph Farrell, *Information and the Coase Theorem*, 1 J. ECON. PERSP. 113, 116 (1987). Indeed, Farrell notes that, even compared to a highly imperfect governmental authority, the superiority of private markets in allocating resources efficiently cannot be assured. *Id.* at 124.

⁸³ Cases involving non-negligible transactions costs are an enormously important category of economic transactions. If transactions costs were negligible, the role of the courts would be minimal, since costless market transactions would replace the legal mechanism. In contract law, if legal rules were clear and impervious to change through litigation, there would be no point in challenging a valid assertion of legal right. Many contract cases, therefore, must involve non-negligible transactions costs. All torts involve transactions costs, since they are by nature involuntary interactions. In all such cases, the risk of litigation is, *ex ante*, preferred by the parties to market interaction and must be less expensive than the perceived transactions costs.

⁸⁴ Cf. John Sutton, *Noncooperative Bargaining Theory: An Introduction*, 53 REV. ECON. STUD. 709 (1986) (reviewing economic literature concluding that bargaining is inefficient if each party has information not available to the other).

⁸⁵ Obviously, this is an entirely empirical issue, one that must be approached on a case-by-case basis. There is no way to predict that any government response will be even more costly than a failed market transaction in every case of market failure. Building barriers against government action, however, makes exactly that presumption. Farrell suggests that an appropriate role for government is not necessarily to achieve optimality, but to bring the parties to a position from which they can privately negotiate, from a position in which private negotiation was not possible. Farrell, *supra* note 82, at 125.

markets exactly when they are least reliable.⁸⁶ Justification for government intervention exists when errors made by common law courts are unlikely to be mitigated by Coaseian neutrality. Since similar vulnerability to organizationally efficient groups seems to be present in both courts and legislatures, the choice between the two is hardly clear-cut.

When markets do fail, governmental action may enhance welfare. Nevertheless, there may be some who will be harmed by such action. Interest groups may therefore oppose regulation, and seek its removal when it exists. In effect, each market failure develops a constituency that benefits from the continued existence of the market failure, and that therefore has an incentive to oppose a governmental remedy. Members of cartels, or monopolists generally, prefer market failure to efficient but competitive rates of return because the market failure is the source of their monopoly profits. Similarly, the failure of the courts to assign liability for external costs⁸⁷ to the appropriate party, or to assign property rights completely, is likely to call forth the opposition of that party to legislative correction of the error.

The same organizational advantages which promote special interest legislation therefore make public-regarding legislation unlikely. Cartels inherently involve small groups likely to be politically effective (in the sense of offering large effective bribes to policymakers), since smaller cartels have lower enforcement costs than do large cartels.⁸⁸ Similarly, smaller groups will typically be the lowest-cost avoider in externality situations, since their organizational efficiency reduces their costs of undertaking transactions.⁸⁹ Obviously, therefore, failure to address market imperfections may benefit small and politically effective groups, who will use their organizational advantages to oppose correction of the imperfection.

Suppose, for example, that a simple cartel enabled its members to extract monopoly rents from consumers of a product.⁹⁰ Let us

⁸⁶ The failure of markets to complete any mutually desirable transaction, for whatever reason, is treated here as a relevant market failure.

⁸⁷ Torts, transactions in which the costs of perpetrators' actions are imposed upon victims, may be seen as a form of externality.

⁸⁸ EDWIN MANSFIELD, *MICROECONOMICS: THEORY AND APPLICATIONS* 343-44 (1988).

⁸⁹ Indeed, non-internalized externalities are more likely in the presence of large groups. Because their organizational costs are lower, small groups may be able to internalize any external effects of the actions of one group member on other group members, whereas if actions of group members affect persons outside the group, they are likely to be beyond the group's reach. The continuing existence of non-internalized externalities may well indicate that courts have not placed the burden on the lowest-cost avoider or internalizer; any change in that status quo arising from legislative action can only work against the interests of the small group, which will therefore oppose such actions.

⁹⁰ Some have argued that natural monopoly would be better left unregulated in any case if the monopolist must bid for the right to be the monopolist. Harold Demsetz,

assume what is surely typical, that the consumers of the product are more numerous, more heterogeneous, more costly to communicate with, and less vitally interested, than are the members of the industry cartel.⁹¹ The public choice model would thus predict that the government will not prevent organizationally efficient cartels from acting as such. The cartel members themselves are a constituency for the continued existence of the cartel.

Of course, antitrust laws⁹² are designed to remedy exactly such situations.⁹³ Nevertheless, resources devoted to public antitrust enforcement are limited, and prosecutors presumably must choose among violators when allocating resources for enforcement. One can easily imagine that the unfortunate parties selected for the government's attention may be those that are uniquely politically vulnerable. These parties are likely to be members of cartels sufficiently large or diverse to encounter organizational difficulties—in short, exactly those cartels least likely to survive in any case.⁹⁴ In this view, antitrust policy is more likely to pose a threat to small firms in large and inefficient cartels than to large, established firms in more effective cartels, though the policy goals of antitrust might be better served by the reverse.⁹⁵

The solution to such difficulties, it would seem, is not to suspend antitrust enforcement altogether, but to expand it, to reduce

Why Regulate Utilities?, 11 J.L. & ECON. 55 (1968); Richard A. Posner, *Natural Monopoly and Its Regulation*, 21 STAN. L. REV. 548, 549 (1969); George J. Stigler & Claire Friedland, *What Can Regulators Regulate? The Case of Electricity*, 5 J.L. & ECON. 1, 11-12 (1962). This argument, however, does not apply to the cartel, which is able to function as such because of the economics of group organization. Why some cartels, like any other group, form successfully and outbid other potential cartels for the right to function, while others fail, remains largely unexplained. Robert Tollison, *Public Choice and Regulation*, 74 VA. L. REV. 339, 342 (1988).

⁹¹ Indeed, the public choice model of group action predicts that successful acquisition of monopoly power is more likely to be made by organizationally efficient groups. See M. OLSON, *supra* note 3, at 143-44.

⁹² See, e.g., Sherman Antitrust Act, 15 U.S.C. §§ 1-7 (1988); Robinson-Patman Act, 15 U.S.C. §§ 13-13b (1988); Clayton Act, 15 U.S.C. §§ 12-27 (1988); Federal Trade Commission Act, 15 U.S.C. §§ 41-51 (1988); Antitrust Civil Process Act, 15 U.S.C. §§ 1311-14, 18 U.S.C. § 1505 (1988).

⁹³ The fundamentally public-regarding character of antitrust law has been conceded by sources likely to be skeptical. Bork, for example, asserts that "the legislative history of the Sherman Act . . . displays the clear and exclusive policy intention of promoting consumer welfare." ROBERT BORK, *THE ANTITRUST PARADOX* 61 (1978).

⁹⁴ The greater the number of firms which are members of a cartel, the more likely it will break down. See, e.g., E. MANSFIELD, *supra* note 88, at 343-44.

⁹⁵ There is much to be said for this view of antitrust enforcement. At this late date, the antitrust laws are, from the perspective of any particular industry, a datum, beyond practical hope of elimination. The alternative is to alter the technical, and politically invisible, rules of operation to make them as beneficial to the group as possible. In short, the existence of antitrust policy expresses public-regarding legislative behavior, while the criteria by which prosecutorial discretion is exercised define the parameters of special interest influence.

the scope of prosecutorial discretion.⁹⁶ The existence of antitrust laws represents a threat even to the large monopolist, who would surely prefer to eliminate that threat. It is in an environment of straightforward adherence to antitrust rules that enforcement will most overtly serve public-interest goals; in an environment of limited resources and prosecutorial discretion, the rules will fail. The goal must be to avoid circumstances in which each set of potential defendants is well-equipped to resist its own prosecution.

Similar considerations apply to externalities. The classic remedy, a tax on an externality-generating activity such as the output of a polluting factory,⁹⁷ in principle informs all parties of the burdens their actions impose on others, who presumably could not otherwise make their feelings known.⁹⁸ If a tax were imposed on factory owners, it seems elementary that, whatever its social justification, the tax would impose an unwanted burden on them, and they could be expected to seek its termination.⁹⁹ If they succeed, the public interest is sacrificed to benefit an organizationally more efficient group that constitutes a constituency against the tax.

Alternative remedies to externalities present similar problems. Suppose property rights in the environment could be assigned to one party or another; this would, in the absence of private information, eliminate the externality completely.¹⁰⁰ Nevertheless, the assignment of property rights will be opposed by the group that is denied the right. Again, the organizationally more efficient group should not (under Calabresian rules) be granted the property right, since it can surmount the costs of bargaining more easily than the less efficient group.¹⁰¹ Therefore, the more efficient group will re-

⁹⁶ For a general discussion of dissatisfaction with the Reagan Administration's emphasis on deregulation, see N.Y. Times, Dec. 11, 1988, at 1, 60, col. 3.

⁹⁷ A.C. FIGOU, *supra* note 28; see also R. BOADWAY, *supra* note 28.

⁹⁸ R. BOADWAY, *supra* note 28. If the factory owner had incentive to exaggerate the true value of the pollution to him in the hopes of extracting additional payments, the externality might not be completely corrected. The complete assignment of property rights will not alone eliminate the welfare losses associated with externalities, as some have asserted, if parties continue to hold private information about their bargaining positions that is not available to their potential negotiating partners. Steven Cheung, *The Fable of the Bees: An Economic Investigation*, 16 J.L. & ECON. 11 (1973); Farrell, *supra* note 82, at 117; Richard Stroup & John Baden, *Externality, Property Rights, and the Management of Our National Forests*, 16 J.L. & ECON. 303 (1973).

⁹⁹ How consumers and producers will share the burden of the tax depends, of course, on the relative magnitudes of supply and demand elasticities for the industry output. See EDGAR BROWNING & JACQUELINE BROWNING, *MICROECONOMIC THEORY AND APPLICATIONS* 460-63 (1983).

¹⁰⁰ See *supra* note 98.

¹⁰¹ G. CALABRESI, *supra* note 66, at 135, 150-52. Groups with lower costs of organizational and collective action are likely to be those which can mount the most effective bribe, as public choice theory presumes in the political context. Calabresi explains that "the best briber" is likely to be the appropriate party to which costs of accidents should

sist proper assignments of property rights. The rights will either be inappropriately assigned to the party with lower transactions costs or will fail to be assigned altogether. Even absent a clear property rule, it is only transactions costs which prevent the parties from reaching an enforceable contract to clarify rights in exchange for appropriate consideration. In any case, the view that externalities exist only because property rights have not been completely assigned begs the question: if courts have not assigned property rights completely though they should have done so, then what appeared to be a failure of the market in fact is a failure of common law courts. In either case, a legislative remedy is necessary.

Some have argued that actual environmental protection statutes (intended to remedy the problems created by externalities) bear little resemblance to such benign taxes.¹⁰² They argue that environmental regulation creates conventional rents by serving as a cartel mechanism for the benefit of existing firms, to the detriment of potential industry entrants. In the initial federal system of environmental control, access to environmental resources was controlled by the enforcement of standards rather than through tradeable property rights. These standards included differential pollution-control requirements on new firms; these requirements limited the entry of new competitors.¹⁰³ Such arguments helped justify attacks on this and other forms of social regulation in the 1980s.¹⁰⁴

be assigned, because that party can most cheaply correct errors in the assignment. *Id.* at 150-52.

¹⁰² Michael Maloney & Robert McCormick, *A Positive Theory of Environmental Quality Regulation*, 25 J.L. & ECON. 99 (1982). Several observers have used public choice theory to justify a view of environmental and other social regulation as fundamentally a cartel mechanism. See, e.g., W. KIP VISCUSI, *REGULATING CONSUMER PRODUCT SAFETY* (1984); Robert Crandall, *Clean Air and Regional Protectionism*, 2 BROOKINGS REV. 17 (1983); Ann Bartel & Lacy Glenn Thomas, *Direct and Indirect Effects of Regulation: A New Look at OSHA's Impact*, 28 J.L. & ECON. 1 (1985). In general, however, the public choice movement's attack on health and safety regulation has been more muted than its attack on traditional price and entry regulation, has focused on its inefficiency rather than its venality, and has suggested alternatives like taxation or reliance on the common law as more efficient. See STEPHEN BREYER, *REGULATION AND ITS REFORM* 96-120, 261-84 (1982); R. POSNER, *supra* note 59, at 279-81; Richard Stewart, *The Discontents of Legalism: Interest Group Relations in Administrative Regulation*, 1985 WIS. L. REV. 655, 678-86.

¹⁰³ For example, the 1970 Clean Air Act imposed standards on existing pollution sources as a function of the ambient air quality, while new firms had to meet the strictest standards regardless of local air quality. Clean Air Act Amendments of 1970, Pub. L. No. 91-604, 84 Stat. 1676 (codified at 42 U.S.C. §§ 7401-7642 (1982)).

¹⁰⁴ See MARTHA DERTHICK & PAUL J. QUIRK, *THE POLITICS OF DEREGULATION* 33-34, 212-18 (1985). Social regulatory agencies were severely affected by the deregulation movement of the 1980s. For example, between 1980 and 1989, the budgets of seven of the ten largest social regulatory agencies—the Environmental Protection Agency, the Coast Guard, the Nuclear Regulatory Commission, the Food Safety Inspection Service, the Food and Drug Administration, the Federal Aviation Administration, the Animal and Plant Health Inspection Service, the Occupational Safety and Health Administration, the

Whether or not existing social regulation creates such rents, public choice explanations for the existence of social regulation are nevertheless extremely implausible, as I explain below. If social regulation cannot be plausibly explained by public choice theories, the proposed restrictions on government become still more questionable. These proposals would, in general, fall equally on both social regulation and traditional economic regulation, yet may not be directed toward a meaningful problem in the area of social regulation. Furthermore, even if public choice presented a satisfying explanation for the existence of social regulatory programs, restrictions on government like those discussed in this Article would nevertheless be unsatisfying solutions: unless we are prepared to tolerate the ongoing existence of substantial externalities, there is little reason to impose new barriers to their correction.

Social regulation is a poor candidate for public choice explanations. By its nature, it affects many industries at once; the involvement of numerous industries and, therefore, large numbers of affected shareholders and managers, poses serious free-rider problems for an interest group trying to elicit action from its members.¹⁰⁵ It usually imposes substantial compliance costs, which fall on the very parties regarded as beneficiaries under a private interest

Office of Surface Mining Reclamation and Enforcement, and the Economic Regulatory Administration—contracted in real terms; of the remaining three, two grew by less than 5% over that period. By contrast, of the ten largest economic regulatory agencies at the start of the 1980-89 period—the Comptroller of the Currency, the Federal Deposit Insurance Corp., the Patent and Trademark Office, the Federal Reserve Board, the Interstate Commerce Commission, the Federal Communications Commission, the Securities and Exchange Commission, the Federal Energy Regulatory Commission, the Federal Trade Commission, and the Department of Justice Antitrust Division—all but four grew in real terms. The cumulative growth rate of economic regulatory agencies for the period was double the average growth rate of social regulatory agencies: 26% versus 13%. Melinda Warren & Kenneth Chilton, *1989 Federal Regulatory Budgets and Staffing: The Effects of the Reagan Presidency* (Washington University Center for the Study of American Business, 1988), cited in 3 REGULATION 12 (1988). Much social deregulation has taken the form of reliance on economic methods of regulation, and less on overt and inflexible controls and standards. The Reagan Administration adopted two such policy reforms: the institutionalization of economic analysis in the regulatory process, and the very limited use of emissions taxes and tradeable emissions rights. Roger Noll, *Regulation After Reagan*, 3 REGULATION 18 (1988). For example, the Reagan EPA replaced regulatory standards for lead emissions with transferable lead-use permits for gasoline refiners, and allowed trading in agricultural water rights. Richard Stroup, *Environmental Policy*, 3 REGULATION 47 (1988).

¹⁰⁵ There has been little effort to resolve just who demands special interest legislation, from the potentially millions of stockholders in an affected industry to the agents, managers, workers, and suppliers of the industry. Presumably all of these parties have interests in the well-being of an industry affected by a piece of legislation. Macey's observation that "everyone agrees that it is the interest groups themselves that are making the demands for favorable legislation" is of little help in this regard. See Macey, *supra* note 11, at 228 n.24. The number of affected individuals could rapidly escalate beyond any intuitive understanding of the upper size limit of a politically effective coalition.

interpretation.¹⁰⁶ Indeed, the magnitude of those costs were widely cited by affected industries as a reason to remove social regulation.¹⁰⁷ And social regulation is unlikely to be an entry-limiting device capable of awarding monopoly power to established firms; that explanation presumes that existing firms would have monopoly power but for the competitive pressure imposed on them by potential entrants. While some parts of American industry may indeed be noncompetitive, that surely is not the rule,¹⁰⁸ and in any case those industries which are competitive would have incentives to resist the imposition upon them of compliance costs unrewarded by new market power.

The special-interest explanation of social regulation also ignores the recurring, short-lived focus of popular attention on particular matters of public concern. Social regulation has typically resulted from widespread public pressure, which has prevailed over the opposition of affected business interests.¹⁰⁹ The Meat Inspection Act¹¹⁰ was rooted in "widespread enmity towards the large meat packers,"¹¹¹ which arose partly in response to public outcry following the publication of Sinclair Lewis's *The Jungle*;¹¹² this public

¹⁰⁶ See, e.g., Murray Weidenbaum, *The High Cost of Government Regulation*, CHALLENGE, Nov./Dec. 1979, at 32. The Weidenbaum study reports, for example, that the auto safety and pollution requirements then present imposed costs of \$7 billion on American automakers through 1978, *id.* at 36; that OSHA standards imposed some \$3.5 billion of capital costs on domestic firms in 1978, *id.* at 37; that annual costs of pollution abatement expenditures ran some \$19.3 billion in 1977 and that some \$361 billion would be spent for that purpose between 1977 and 1986, *id.* at 37; and that paperwork and reporting requirements imposed an additional \$63 billion in 1976. *Id.*

¹⁰⁷ See ARTHUR ANDERSEN AND COMPANY, COSTS OF GOVERNMENT REGULATION STUDY FOR THE BUSINESS ROUNDTABLE (1979). One estimate of the costs imposed by the Occupational Safety and Health Administration, for example, placed the burden on industry of complying with its regulatory standards at almost \$2.7 billion per year. Murray Weidenbaum & Robert DeFina, *The Costs of Federal Regulation of Economic Activity* (AEI Reprint No. 88, 1978). Edward Denison estimated that pollution abatement and worker safety and health programs of the federal government reduced the growth rate of the U.S. economy in the late 1970s by some 0.35 percentage points. EDWARD DENISON, ACCOUNTING FOR SLOWER ECONOMIC GROWTH 128 (1979); see also J. Miller & J. Eisenach, *Regulatory Reform under Ronald Reagan*, in THE FUTURE UNDER PRESIDENT REAGAN 89-100 (W. Valis ed. 1981).

¹⁰⁸ Arnold C. Harberger, *Monopoly and Resource Allocation*, 44 AM. ECON. REV. No. 2 at 77 (1954).

¹⁰⁹ For a discussion of opposition to the enactment of NEPA and the Clean Air Act Amendments of 1970, see RICHARD LIROFF, A NATIONAL POLICY FOR THE ENVIRONMENT: NEPA AND ITS AFTERMATH 30-31 (1976); Helen Ingram, *The Political Rationality of Innovation: The Clean Air Act Amendments of 1970*, in APPROACHES TO CONTROLLING AIR POLLUTION 12-56 (A. Friedlander ed. 1978).

¹¹⁰ Act of June 30, 1906, ch. 3913, 34 Stat. 669 (current version at 21 U.S.C. § 694 (1982)).

¹¹¹ Robert Rabin, *Federal Regulation in Historical Perspective*, 38 STAN. L. REV. 1189, 1225 (1986).

¹¹² See *id.* at 1226.

pressure also resulted in the passage of the Pure Food and Drugs Act.¹¹³ The 1962 Drug Amendments were passed in the wake of widespread public alarm over thalidomide.¹¹⁴ Similarly, the social regulation of the early 1970's came in reaction to mass public movement.¹¹⁵ Public choice theory assumes the absence of an involved public, and theories about what happens in its absence. In these cases, however, public attention was both widespread and effective, albeit only temporarily.¹¹⁶

There is another reason to question the view that social regulation has been sought by industry as a means to capture cartel-like rents from government output restrictions. This view ignores an extensive body of evidence that many such regulatory initiatives have reduced the stock market value of the regulated firms.¹¹⁷ The sim-

¹¹³ Act of June 30, 1906, ch. 3915, §§ 1-2, 34 Stat. 768, *repealed by* Federal Food, Drugs, and Cosmetic Act of 1938, ch. 675, § 902(a), 52 Stat. 1059; *see* Rabin, *supra* note 111, at 1227.

¹¹⁴ Drug Amendments of 1962, Pub. L. No. 87-781 (codified as amended in scattered sections of 21 U.S.C.). *See* RICHARD A. MERRILL & PETER BARTON HUTT, *FOOD AND DRUG LAW: CASES AND MATERIALS* 353 (1980).

¹¹⁵ *See* Rabin, *supra* note 111, at 1281-84. For another description of the enactment of the environmental and consumerist legislation of the period, *see* M. PERTSCHUK, *supra* note 18, at 13-45.

¹¹⁶ More traditional economic regulation, by contrast, often originated in overt efforts by favored business interests to obtain that legislation. For example, in the Progressive Era between 1890 and 1914, business interests sought reassurance through regulation that business practices of the day were legally acceptable. *See* Rabin, *supra* note 111, at 1220. Intense political combat between farmers and other users of railroad shipping services, and the railroads themselves, which sought "freedom to engage in pooling arrangements to 'rationalize' rates," produced the Interstate Commerce Act. *Id.* at 1206-07. The Federal Trade Commission Act, 38 Stat. 717 (codified as amended at 15 U.S.C. §§ 41-51 (1988)), resulted in important part from the lobbying efforts of the National Civic Federation, a group of business and civic leaders who focused on obtaining government assistance to create an environment in which business cooperation and consolidation could thrive. As a result, the legislation failed to define a clear pro-competitive mandate for the newly-created Federal Trade Commission. Rabin, *supra* note 111, at 1221, 1223-1224. Vagueness in the definition of the regulatory agency's mandate left clear opportunity for sustained special interest pressure on the agency after public attention had passed.

¹¹⁷ James Bicksler & Patrick Hess, *A Note on the Profits and Riskiness of Defense Contractors*, 49 J. Bus. 555 (1976) (finding no evidence of abnormal returns to defense contractors' securities during period of increased regulatory controls); Malcolm R. Burns, *The Competitive Effects of Trust-Busting: A Portfolio Analysis*, 85 J. POL. ECON. 717 (1977) (anti-trust dissolutions carried out under the Sherman Act reduced the equity values of affected firms by between 9 and 16 percent); Roger G. Clarke, *The Effect of Fuel Adjustment Clauses on the Systematic Risk and Market Values of Electric Utilities*, 35 J. FIN. 347 (1980) (uses stock market excess returns analysis to demonstrate that the adoption of fuel adjustment clauses between 1965 and 1974 resulted in no abnormal returns to shareholders of regulated electric utilities); Gregg Jarrell & Sam Peltzman, *The Impact of Product Recalls on the Wealth of Sellers*, 93 J. POL. ECON. 512 (1985) (regulatory recalls of pharmaceutical products reduced the equity value of affected firms by about 6 percent; automobile recalls by the National Highway Traffic and Safety Administration resulted in losses of about 1.5% of equity value); Sam Peltzman, *The Effects of FTC Advertising Regulation*, 24 J.L. & ECON.

ple reality is that the implementation of social regulation was often opposed by affected business lobbying,¹¹⁸ and for good reason.

As with externalities, similarly with public goods.¹¹⁹ Whatever their public virtues, not all public goods are equally likely to be supplied. The public goods most likely to be supplied through public financing are those that coincide with private rewards.¹²⁰ The greater the private good component of such a combined good, the more likely free rider problems will be overcome; public goods (like public-regarding legislation) with inadequate private goods components are likely not to be supplied. Furthermore, parties who believe themselves taxed in excess of the benefits they derive from the public good will oppose its provision or seek its termination. Since the public good, by assumption, improves society's welfare in a utilitarian sense, it is plausible that the group opposing the action will be smaller and thus more effective than the group supporting it.

In sum, when a market failure occurs, there may be a constituency formed by that market failure which will resist legislative efforts to correct any resulting inefficiency.¹²¹ Thus, failure of the legisla-

403 (1981) (deceptive advertising cases brought by the FTC were found to reduce the net worth of affected firms by 3 percent); Paul H. Rubin, R. Dennis Murphy & Gregg Jarrell, *Risky Products, Risky Stocks*, 1 REGULATION 35, 36 (1988) (Consumer Product Safety Commission product recalls "are very costly, resulting in large drops in the stock prices of affected firms."); William Schwert, *Public Regulation of National Securities Exchanges: A Test of the Capture Hypothesis*, 8 BELL J. ECON. 128 (1977) (proposal of Securities Exchange Act of 1934 in Congress significantly reduced New York and American Stock Exchange seat prices); Robert I. Chien & Roger B. Upson, *Returns to Drug Industry Common Stocks: An Alternative Measure of Economic Profitability* (1978) (unpublished manuscript, U. of Minnesota Graduate School of Business) (revision of proposed legislation to give Food and Drug Administration new powers resulted in decline of 11 percent in pharmaceutical firms' share values); R. Ruback, *The Effect of Discretionary Price Control Decisions on Equity Values* (1980) (unpublished doctoral dissertation, University of Rochester, School of Management) (finding that violations of price controls detected and punished by regulatory commission caused reductions in the equity values of offending firms).

¹¹⁸ See, e.g., Weidenbaum, *supra* note 106, at 32:

It needs to be recognized that impetus for most of the expansion in government power over business is not being provided by the industries being regulated. Generally, they have shown minimum enthusiasm for EPA, OSHA, ERISA, the Equal Employment Opportunity Commission (EEOC), and so on. If anything, the companies claim that the "benefits" to them of these regulations are negative. The pressures for the new style of regulation come, rather, from a variety of citizen groups concerned primarily with noneconomic aspects of our national life—environmentalists, consumer groups, labor unions, and civil rights organizations.

¹¹⁹ The concept of public goods has a long history in economic literature. It was first formalized by Paul Samuelson in 1954. See Paul Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 386 (1954).

¹²⁰ See M. OLSON, *supra* note 3, at 51, 133-34.

¹²¹ I do not mean to exclude the possibility that there may be legitimate reasons for governmental action other than economic efficiency. For example, there may be redistribution for reasons other than private interest; obviously, the parties likely to bear the costs of that redistribution may oppose it. Nevertheless, there is no clear criterion of the

tive process results not only from active lobbying on behalf of private interest legislation, but also from the active resistance of groups which benefit from the absence of legislation. Their resistance is as much a problem for the democratic system as their search for new special favors. New barriers to legislative action simply aid their efforts.¹²²

CONCLUSION

If the existence of regulation leads us to suspect the operation of private interest politics, the absence of regulation should lead us to suspect the very same. When we observe, for example, a generally unregulated industry, that may be a triumph of a public-spirited defense of the free market—or a failure to give adequate representation to the public will. When an industry is actively regulated, a private interest group may have triumphed, or may have been defeated. When we observe successful deregulation, the special interests may just have been defeated—or did they just win the field?

We cannot completely trust any private ordering to be free of the taint of special interest. Nor can we rely on the political system to generate consistently desirable results. At best we can build explicit safeguards against the use of government for private ends. Limits on campaign contributions, ethical standards for public officials, and similar conventional solutions to the problem of private interest offer far more hope for the elimination of private interest from our public affairs than do one-sided limits on the role of government.

public interest in this case, as there is with economic efficiency. For that reason, the argument is phrased in terms of economic considerations, but no loss of generality is intended.

¹²² Some may believe that private outcomes, whatever their source, have an overriding moral validation simply because those results are private. See *Active Judges*, *supra* note 12. That is not, however, the basis on which the public choice literature has grounded its attack on rent-seeking legislation; that attack has had its appeal because it appeared to be based on distributionally neutral and uncontroversial criteria.