

THE ROLE, LIMITATIONS AND LEGITIMACY OF REGULATORY MECHANISMS IN MARKET ECONOMIES

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An essay on a Ditchley Foundations conference held at Ditchley Park, Oxfordshire, England on the weekend of 23-25 February 1996.

The charge at this Ditchley conference was a broad one: we were to review the proper scope of regulation and examine how that function might best be organized and controlled. The conference focused on regulations of the entry and price variety, since prior Ditchley conferences had dealt with "social" regulation, such as environmental, civil rights, and privacy issues.

Before engaging the specifics discussed at the conference, it is useful to develop a few themes to place these remarks in context. Section I includes an essay contrasting two polar perspectives on regulation, the backgrounds and inclinations of those attending the conference, the timing of the conference, and whether the overall trend is toward more or less regulation. Sections II-IV summarize the treatment of the three major questions asked of the participants: What should be regulated? How should the regulatory function be structured? How can the regulatory process be held publicly accountable?

Section I: Two Perspectives on Regulation

A framing of this Ditchley conference is provided by an essay by a British economist, Professor Ronald Coase, commenting on the views of another British economist, A.C. Pigou. Pigou was writing in the early part of this century and was dealing with the case for government intervention in the economy. Pigou believed such intervention was warranted whenever the free play of self-interest would otherwise reduce or distort socially optimal decisions. Pigou believed such situations were pervasive. As the father of modern welfare economics, Pigou's work was relevant to the Ditchley conference, since his efforts both signalled the intellectual rejection of the *laissez faire* policies of his economic predecessors and provided the intellectual base for the modern regulatory state.

The work of Ronald Coase, who was awarded the Nobel Prize in Economics for his work clarifying the actual workings of a market economy and his focus on the institutional framework within which individuals act, is perhaps even more relevant, since Coase's work provides much of the intellectual basis for rethinking the presumption that government intervention will readily advance the public interest. Coase argues that we must look beyond the conceptual failures of markets (or governments, for that matter) to their comparative performance in a world where most institutional arrangements fall far short of perfection.

Pigou viewed markets as deeply flawed institutions, but he was well acquainted with the dismal record of government in seeking to intervene in matters economic. He identified two major problems with such political intervention: the **knowledge problem**, that a political agency would find it hard to acquire and utilize the information needed to handle the economy; and, the **rent-seeking problem**, that a political agency would find it difficult to avoid favoring powerful interest groups. To Pigou, these problems varied with culture, place and time: and Pigou was optimistic that, at least, twentieth-century England then possessed the honesty and unselfishness and the electorate capacity to regulate effectively. Pigou argued, around the turn of the century, "... there is now a greater likelihood that any given piece of interference, by any given public authority, will prove beneficial than there was in former times".

Pigou's optimism stemmed in part from his faith in the intellectual class in England (his class) and in part from his hopes for the modern independent regulatory commission which had recently been "invented" in the United States. Such an "independent" agency, Pigou believed, would be free to hire and train the most qualified civil servants and would avoid the corrupting influence of politics.

History has not been kind to Pigou's hopes. "Independence" neither prevented political interference nor resolved the knowledge problem. Indeed, Pigou's exemplar of the "Brave New World" of positive political intervention was the US Interstate Commerce Commission (ICC) created in 1887. And it is certainly true that hopes ran high when the ICC was first created. The ICC went into battle with streamers flying but was soon captured by the interest groups it sought to regulate. By the 1960s the ICC was widely regarded by scholars of all stripes as a failure, an agency that retarded rather than advanced the public interest in quality ground transportation. As a result the Interstate Commerce Act was repealed in the early 1990s.

Coase's criticisms of Pigou - and more generally of the whole view that market failures justify government intervention - do not suggest that regulation is never warranted, but are intended rather to demonstrate that this question can be answered only by viewing carefully the comparative strengths and weaknesses of political and private arrangements. How do the incentives arising from the respective institutions channel individual self-interest, how does the institutional framework adjust to

mistakes or learn over time? At what times and places might we expect regulation to work better, or worse? How do we move beyond the conceptual case for government intervention, or for *laissez faire* policies, to reasonably effective practical policies?

Elements of Pigou's optimism about the ability of (European, at least) regulatory agencies to advance the public good were present at the conference. The dominant view however tended more toward the pragmatism of Coase. The discussion was also replete with calls for a careful comparative analysis of the pros and cons of market vs. political approaches. The consensus was summarized by one participant as follows: "We shall undoubtedly have to regulate, but we should do so with a light touch and with modest expectations".

The Participants and the Charge

Pigou's observation that culture and place might well affect the efficacy of regulation is certainly true. In this regard the varied backgrounds of the conference participants provided an interesting array of perspectives. Some participants placed great weight on distributional and other fairness issues handled inadequately, in their view, by the market. They argued that consumers lacked both the knowledge and the power to ensure fairness in an unregulated marketplace. Others placed equally great weight on individual and economic liberty and far less faith in political processes. In part that dispute reflected an issue of trust: those favoring an expanded role for collective action believed that institutions could advance the public interest; those favoring economic liberty believed that self-interest was far more dangerous in the political world. The dominant viewpoint however was that of the rational managers (the "Good Government" types) who believed that regulation, like any tool, can yield useful results as long as it is carefully managed by well-trained civil servants. That a meeting of intellectuals would reach consensus that they could design and staff agencies to reasonably advance the public good is not surprising. Consensus was not the overriding objective of the conference. Rather we sought a better understanding of the often conflicting perspectives that have dominated, and continue to dominate, most regulatory policy debates.

The participants came from a range of nations (the United Kingdom, the United States and Canada with an important leavening of continental Europeans) and professional backgrounds (regulatory agencies, regulated industries and academically-related disciplines). By and large, participants broke down into two main types: Europeans generally saw a somewhat larger role for government regulation and tended to be more optimistic about the ability of "making it work". Americans generally were more leery of such interventions and tended to emphasize the "Dark Side of the Force".

Ditchley participants included various types of "regulators". There were the "kind" regulators (those who favor regulation as a tool of redistributive justice); the "good" regulators (those who see regulation as a means of achieving a variety of socially valuable results); the "limited" regulators (those who would restrict regulation to "perfecting" markets); the "disillusioned"

regulators (those who despair that the regulatory process can ever be made to work but believe it unavoidable on either conceptual or political grounds); and, the "anti-regulators" (those who believe that regulatory political interventions are unlikely ever to advance human welfare and should therefore be abolished).

Few participants espoused the optimistic Pigouvian attitude, in part because of the often sobering US regulatory experiences. Moreover, market approaches have gained much greater respect over the last century. The dominant view was not a free-market perspective but rather a cautious view that regulation was a valuable and unavoidable feature of modern society. Specific situations might be improved by regulatory intervention; in other cases populist pressures might make it impossible to avoid regulation. It was also argued that regulation might play a useful transitional role as European countries shift from governmental to private ownership of water and other utility services.

The fact that regulation was introduced earlier in America and was relied upon there more than in Europe accounts in part for the differences among the participants. The American experience with entry and rate regulation has been "a sobering one" which made the Americans the most skeptical of the participants. The Europeans, currently engaged in privatizing their state enterprises and moving toward greater reliance on market forces, viewed regulation more as an economic liberalizing step.

The variety of the participants ensured acceptance of the Pigouvian view that the regulatory process might work more smoothly in some cultures than in others. The nature of European culture, where technical elites are accorded greater respect and legitimacy than in the US, means that an "independent" agency might well have greater legitimacy, be seen as more "trustworthy" and make it possible to reach and implement rational decisions. The egalitarian/populist culture of the United States makes that outcome far less likely. (The terminology mostly employed for government employees - in the United States, "bureaucrats"; in Europe, "civil servants", - suggests this cultural difference.) In any event, US observers doubted whether this relative freedom from political interference would long survive; Canadian observers tended to agree. Indeed, one participant suggested that such European optimism demonstrated clearly the triumph of hope over experience.

The conference helped dispel the sometimes implicit mutual misunderstanding that American and European societies are polar opposites: the United States, a *laissez faire* cowboy economy; Europe, a model of state socialism. In some respects, Europe has been less politicized than the United States. American-style antitrust regulations, for example, have only recently been introduced to Europe. And it was the UK which first moved to privatize and deregulate the electricity industry. In contrast, government ownership of vast land areas (specifically in the western states and Alaska) has been far more extensive in the United States than in Europe. The trend is toward convergence, with cultural and historic differences gradually becoming less

significant as the global economy becomes an ever more real phenomena.

Timing and Background

It was recognized that the regulatory experiences of Canada, Europe (in particular the United Kingdom) and the US differed significantly. These nations responded differently when progressive thinking came to dominate Western policy in the late nineteenth century. Europe and, to a lesser extent, Canada responded by nationalizing sectors of their economies in the belief that direct government provision was more likely to advance the public good. In contrast the US largely avoided nationalization, leaving assets nominally in private hands but then imposing on them various regulatory controls. Common-carriage obligations, for example, might require utilities to provide "universal service" - service to all households within their territory.

The European variety of government intervention is (temporarily at least) in disfavor. Privatization is increasingly seen as preferable to government ownership in most areas. As noted, however, this shift to privatization has been toward regulated rather than free markets. It was noted that an expanded private world provides more scope for regulation - after all, how can one regulate a government agency? It was acknowledged that the European shift was prompted largely by the widespread failure of state enterprises, coupled with a continued view that free markets are either inherently unstable (concern over monopolization tendencies and systemic risks) or unfair (the view that markets are inadequately sensitive to distributional concerns). Some of these regulatory interventions were viewed as transitional, to be phased out as the industry moves fully into the private sector. Others, such as Europe's adaptation of American-style anti-trust laws, were viewed as permanent.

The conference was timely because the shift away from the nationalized economy to the regulated economy was taking place with little consideration of the US experience. In part, that reflected the European viewpoint that the regulatory experience in Europe (with the greater respect granted expertise there and the reduced political conflict associated with parliamentary governments) would differ appreciably from that of the United States. In part, however, it seems simply to reflect the lack of adequate comparative studies and their distribution to interested parties. Much of the discussion sought to fill that gap.

Is Regulation Increasing or Decreasing?

The regulatory picture is even more confused than the above suggests. While both Europe and North America are increasing regulation in some areas, both are simultaneously deregulating in others. Key examples include the move to deregulate telecommunications and electricity as the case for presuming them inevitable natural monopolies fades. In addition, national regulation of banking and other financial services is being reduced under competitive pressures resulting from world competition, along with very significant institutional and technological changes.

The primary factor which argues for regulation expanding over time is that markets are not reassuring institutions. Long-established firms find themselves threatened with technological obsolescence. Domestic firms find themselves beset by fierce foreign competition. Many are troubled by what Schumpeter defined as the destructive storm of competition, and are easily convinced that some form of government intervention will alleviate the situation. Nobel prize economist George Stigler states, "Competition, like exercise, is universally agreed to be good for other people!" Those threatened by change will seek government assistance, including regulation, to "level the playing field" so as to retain their past privileges. This search for an all-gain/no-pain form of capitalism has been a powerful force for regulatory expansion.

The group expressed general concern over this misuse of regulatory policy and noted specifically the risk that trade regulations might all too easily become a disguised form of protectionism. Yet the tendency of domestic firms working closely with domestic regulators to impose on foreign competitors the burdens (even if irrational) legislated locally is strong and likely to continue. No one was opposed *per se* to policies calling for "harmonization" or a "level playing field", but several participants noted that there was often no rationale for such uniform regulatory policies. Local conditions vary widely and so also should site-specific regulatory design. The group however had no decisive answer as to how special interest pressures to harmonize, regardless of the wisdom of such actions, might best be resisted.

It was noted that private pressures for increased regulation were often reinforced by the actions of the regulators themselves. Regulators, too, can be aggressive and entrepreneurial. History suggests that this problem is real; the ICC expanded its scope in the 1930s to regulate its newly emergent competitor, the over-the-road freight trucking sector. That such an evolution, by expanding the scope of private competition, might have obviated the need for regulation was not considered by the ICC. This "regulatory creep" phenomenon was identified as a potential problem by several of the participants. One participant suggested that regulators too often acted like "feudal lords".

Still another factor leading to greater regulation over time is the fact that government rarely retreats from a field entirely. Politicians seek alternative ways of achieving their goals. Thus, as other government tools become less attractive, regulations will expand to fill the gap. And in a time of ever-tightening constraints on government spending regulations have the very great advantage of imposing their costs off-budget. Private parties incur the costs, not the regulatory agency itself.

For such reasons, the extent of regulation is growing. There are however off-setting factors which are reducing the extent of regulation. Regulations require that the regulators understand to some degree the operations of the industry they regulate. That understanding becomes increasingly difficult in today's world of rapid technological and institutional change. In our swiftly evolving world the regulators may fall behind and individual sectors can become effectively deregulated.

Effective deregulation - and thus calls for eliminating the residual burdens - can occur as entrepreneurs by-pass the regulatory process either by shifting operations to nations with less restrictive regulatory regimes or through alternative technologies outside an agency's regulatory ambit.

One factor leading to less regulation over time is cost. Regulatory costs are borne by the private sector directly and threaten their competitiveness in world markets. That factor restrains the regulator. In effect, regulatory bureaucracies compete with each other and that process both disciplines and improves the regulatory process. (US banking regulatory agencies for many decades competed with one another to gain a greater share of the financial service industry; overly costly regulations encouraged firms to move their operating charter to the less onerous regulator. That "warring bureaucracy" model was discussed only briefly at the conference but merits further examination.) Today, in the United States alone, regulatory costs are estimated to exceed \$600 billion annually. Higher costs and the tensions created by such costs are forcing localities, states and even nations to reappraise the value and appropriateness of regulation.

All regulatory activities, it was noted are disciplined by the ability of regulated parties to "vote with their feet" - to move away from areas of excessive regulation to areas of greater entrepreneurial freedom. Such by-pass strategies have been an important element of the deregulation moves of the last two decades (for example, the elimination of Regulation Q in the US financial service industry).

The overall trend is unclear but, for the moment, the world seems headed toward the US model of nominally private firms subjected to regulatory controls of a more or less pervasive nature. Whether this situation entails a more or less politicized economy cannot yet be determined.

Section II What Should Be Regulated?

As one participant noted, regulations are simply a tool of government; thus the debate about the appropriate role for regulation is similar to the more general debate about the role of government itself. The Americans, ever mindful of President Washington's likening of government to fire as an essential but dangerous servant, saw the greatest risks in expanded regulation and would confine its scope.

Traditional economics provides one way of achieving that delineation. The traditional and dominant view at the conference was that regulation should reinforce and work with market forces. The terms of reference suggested that the provision of "essential" services might be regulated, specifically when such provision was likely to entail "monopoly" providers (water or electricity, for example) or when they entailed major risks for the individual citizen (as in the case of banking services). The group generally accepted the standard textbook "market failure" list: natural monopolies, more general anti-trust or pro-competition goals, information imperfections, systemic risks, externalities, and public goods.

The group was aware that these criteria are not definitive and might lead to excessive regulation. Most agreed that in practice societies tended to regulate far more than might be justified by these classification rationales. It was noted that, while regulation was essential, the goal should be to regulate "lightly".

The concern that unregulated markets might degenerate into non-competitive monopolies received considerable attention during the conference. Regulation, one participant argued, might provide a proxy for the absence of competition. Some were skeptical of the "natural monopoly" rationale. The natural monopoly argument begs two important issues: first, how transient is the alleged market dominance, and, second, how do markets respond to efforts to monopolize. Some participants noted that today's global economy of rapid institutional and technological change makes most "natural" monopolies rare and short-lived. One suggested that a regulatory agency might respond more rapidly to resolve such limited-competition problems faster than the market, but that point was contested by others. Most seemed to view anti-trust or competition regulation as more benign than other forms of regulation. (A review of US anti-trust policy might have given more pause in this area, but time and knowledge level prevented an adequate tutorial.) Competition or anti-trust regulation does seem the one area where most felt "harmonization" at the European, if not global, level made sense.

Information asymmetries deal with the concern that parties vary in the information they bring to an agreement. Consumers, some participants believed, are too often at the mercy of the more informed and more skilled producers, and government regulations are therefore needed to ensure a "fair" bargaining situation. Whether information disclosure is an adequate response to this concern - and indeed whether alternative information provision channels (consumer guides, purchasing clubs, brand names, guarantees) might not constitute an adequate market response - received light attention. Concern was expressed by one participant that any effort to ensure the "wisdom" of an economic exchange would constitute a *de facto* program of ensuring that people not make fools of themselves. It was argued that the attempt might well lead to some fairly foolish results.

The systemic-risk rationale for regulation deals with the widespread, if vague, notion that certain economic activities involve large-scale, low-probability risks that could not be addressed by private action. To one participant, regulation is advisable when the consequences of market decisions might be "serious and difficult". An example is the often-cited fear of a "bank run" - a situation in which the failure of one institution would create widespread panic among the population causing otherwise healthy institutions to fail. It is argued that the vast losses that might occur from a "run on the banks" could never be borne privately. Government must cover such risks; this action in turn necessitates however that government then regulate banking activities (that is, watch over the safety and soundness of those it insures). Unfortunately, the regulations imposed on the banking

industry may actually decrease portfolio diversification and even profitability, and thus increase overall risks. The US experience with both "deposit insurance" and the regulatory oversight function justified by such insurance provides little confidence that government is the obvious way of reducing such systemic risks. Vast sums were misdirected toward risky and away from prudent US saving institutions during the 1980s because of such poorly-designed regulatory incentives. On this topic, European participants broke ranks. Some regulators seemed certain that their interventions had advanced the public interest; some of those regulated seemed equally confident that such interventions had made a bad situation much worse.

Externalities and public-goods rationales for regulation apply mostly to regulations in the safety, health and environmental categories (SHE regulations) and other social regulatory areas. Environmental and other regulation had been covered in an earlier Ditchley conference, so these approaches received little attention.

This dominant "market rationale" for regulation was felt too limiting by some participants, too open-ended by others. Those viewing regulations in a positive light recognized that all regulations have distributional impacts and seemed inclined to favor regulatory policies designed to improve income equality.

Often for example firms providing so-called "essential" services are forced to provide universal service. Of course regulations will often be popular with those subsidized, less so with those paying the resulting higher fees. One participant suggested that the egalitarian (helping the less fortunate) goals supposedly advanced by such policies deserved careful scrutiny. After all, powerful political groups are often unhappy about market outcomes and may well call upon regulators to reverse the outcome. The complex off-budget nature of reality may make such special-interest arrangements easier, if more costly, for society.

As noted, the special problems faced in Europe in privatizing the nationalised sectors of the economy encouraged participants to give some consideration to transitional regulatory rules to smooth the move to private status. It was noted however that such transitional regulations may be difficult to phase out. There is never a "right" time to free prices.

A small minority argued consistently that regulations were rarely, if ever, justified. That group differed from the majority who viewed regulation as inherently political. (Future conferences might focus on private regulation - industry standards, trade associations and private certification programs, Better Business Bureaux, brand and certification group labeling, private insurance.) To these "anti-regulators" the "market failure" arguments were too often only rationalizations for politically popular interventions. Markets, they argued, are not perfect, but are far more likely to advance public goals. Neither monopolies nor market failures, they suggested, were likely to persist in the absence of government action. This group viewed competition as a far more effective means of regulating economic behavior so as to advance the public interest. Indeed, in today's world of multinational corporations making frequent decisions as

to where to locate and how to operate, the most significant restraints may well be driven by private market forces. To a great extent global interaction has forced reconciliation and commonality of practices.

Market advocates were challenged. Some participants held that the US experience suggests that private self-regulation does not work well. Private or even decentralized regulation, it was argued, would too often discriminate against the "better" firms, leading to a "race to the bottom".

There were great differences within the group over the proper scope and scale of regulation; still, most agreed that, in practice, regulation was resorted to far more than justified by rational policy. There was a suggestion that we should view regulations as a final resort, to be resisted and pruned at every opportunity. The pragmatists, who believed that political pressures and/or real opportunities would nonetheless ensure a major role for regulatory interventions for the conceivable future, suggested that government should seek to moderate the expectations of the electorate, to encourage voters to expect only modest gains from regulation in practice.

Section III: How Do We Regulate?

It was recognized that if regulation is to play an effective role, it must attract and retain staff capable of dealing with the complexities of the sector regulated. This requires staff able to understand and deal intelligently with those in the industries affected. This problem was addressed, but not resolved, during the conference. Individuals most capable of understanding and adapting to the often rapid changes in a specific industry may exist, but will they be attracted to government? That question may well have a different answer in the United States from that in Europe and Canada - and it may be an answer that varies with the industries affected and with time.

Some with experience in the banking field seemed confident that the quality of those attracted to this regulatory area was generally high. There was also a fair degree of exchange between the financial service industry and the regulatory agencies. Bright young individuals were brought into the agency, trained and given oversight responsibilities, then moved into the private sector. This life-cycle suggests certain problems, such as whether the now-more-experienced individuals would be able to neutralise the very regulations they enacted while at the agency? How to insure against conflict of interest in this situation was unclear.

Some suggested simply ruling out any jobs in the affected industries for some period of time - perhaps permanently. That policy however implies that those most ignorant of the field constitute the best regulators - not a very attractive option. In practice, such a rule would probably mean that regulatory staff would be recruited from the academic as opposed to the business world. Some participants thought that was a very good thing; others were less convinced that academics would understand the practical workings of the business sector.

To address the problems of regulating an industry undergoing rapid change some regulators have imposed

regulations that require prior approval of change. In the United States the Food and Drug Administration, the Environmental Protection Agency and a host of other agencies require that evidence of "safety" be produced before a product can be marketed. The effect is to slow rates of change, allowing the regulators more time to review industry actions. Such "gatekeeper" regulations may however also retard technological change and bias such change toward rule attainment rather than consumer welfare.

A question asked throughout the conference but never definitively answered was how to structure the regulatory function so that it remains limited in scale and scope. Suggestions included regulatory sunset provisions - requirements that the legislative bodies be required to re-enact (and thus reconsider) all regulatory bills from time to time. Given the difficulty of such control, it was argued that new regulations should be enacted only with caution. The regulatory cure, it was noted, may be worse than the disease.

The group condemned the growing practice of exporting domestic regulations by means of trade sanctions, arguing that this constituted a new form of protectionism. One participant mentioned the European rulings specifying the standards that sausages and chocolates must meet to satisfy EU rules, a ruling that, apparently, will require British sausages and chocolates to be re-named.

The focus of the conference on "independent" regulatory agencies ensured that we would be dealing with situations where the agency is in some degree immune from close scrutiny by the political regime. The level of independence will differ in the US and Europe because of the dual-management responsibilities inherent in a President/Congressional as opposed to a Parliamentary system. In the US congressional oversight agencies may exercise considerable influence over an "independent" agency, in part because Congress controls the agency's budget.

Independence thus does not imply freedom from external influence. Indeed industry may well exercise greater influence in such situations. After all, the isolation of the regulatory agency sometimes means that only those within the regulated industries will devote the time to acquaint themselves with the agency and its problems. As a result, the regulated may be more expert on the rule-making process than anyone outside the agency; indeed, the industry representative to the agency might well have once worked in the agency. Yet, as noted earlier, efforts to preclude such close associations may weaken the ability of the agency to attract qualified staff and may reduce the effectiveness and applicability of the regulations promulgated.

Should an agency seek court review of its policies? In the US this question led to the creation of the Administrative Procedures Act, a procedural guideline requiring an agency to follow a specified procedure in developing any regulation. The purpose is to ensure a level of predictability in the process and to ensure that all parties have the opportunity to make their reservations and comments known. In Europe, the more consultative nature of decision-making - the greater trust afforded the

regulatory agency - and thus the ability to meet closely to determine policies cooperatively makes such a quasi-judicial process less necessary. Several of the participants, however, thought that the European process would move toward the more litigious US system over time as trust in political institutions in Europe continued to decline.

Transparency, it was generally believed, would encourage a more reasoned regulatory process. That ambiguity might be valuable to the regulatory agency was not discussed in any detail.

The issue of how regulation should be designed gave rise to several disputes. Should a regulation be uniform or vary according to local conditions? In principle, all agreed that similar situations should be dealt with similarly; in principle, all agreed also that local situations varied widely and that so also should the appropriate intervention mechanism. As always the devil was in the details. Harmonization, it was noted, was more likely to be favored by the large firm producing for a national market than by the smaller firm producing for a regional or local market.

One commentator noted the "Law of Unintended Consequences" - the fact that political interventions never have only one impact. The implication was that we should regulate rarely and lightly to avoid creating problems elsewhere!

One hope repeated frequently in the proceedings was that, while the regulatory agencies must be governmental, they should not be political. Unfortunately, ideas as to how one should design a "non-political form of politics" remained vague to most participants.

Several participants noted the tension between regulatory flexibility (essential to ensure regulation appropriate to the specific circumstance being controlled) and certainty (important for business to make longer term plans). Flexibility got the nod here. There was general concern, however, that an agency that could too easily modify its rules might also too easily abuse its powers.

Some expressed concern that a regulatory agency might abuse the gains from a more flexible approach. For example, a firm that exceeded regulatory requirements might encourage the regulatory agency simply to raise the mandates. Such a "do well and we'll raise the hurdles" approach creates few incentives to exceed the regulatory requirements.

Some technical suggestions were made during the proceedings. For example, the case was made that prices were more readily regulated by means of setting caps than by specific rate-determination policies. It was noted that a cap that gradually increased would eventually become irrelevant; the cap would initially constrain many rates, but as it increased over time prices would increasingly be determined by market realities.

Section IV: Accountability

Regulatory agencies, it was believed, must somehow be made accountable to the citizenry. No agency should be above democratic control. Whether this is best done by control over the agency budget, oversight of the agency's actions, or simply ensuring that the agency is staffed by appropriate individuals is unclear. Too often,

it was argued, the regulators felt free from any constraints; one observer argued that, in his experience, regulators acted like "feudal lords".

One participant noted that accountability might positively be inappropriate if it reduced the agency's operating freedom. As an example, he cited the situation where individuals favoring deregulation were appointed to head various regulatory agencies (the ICC and the Civilian Aeronautics Board). Those individuals moved aggressively to deregulate their respective agencies, largely ignoring the complaints of congressional and business leaders who still favored regulation. The appointees in this situation owed their allegiance to outside institutions (business or the academic world) and felt free to advance a deregulatory agenda even though such actions were extremely controversial in the broader political arena. Accountability, it was suggested, might have blocked deregulation. Yet this very independence also made some uneasy, for it is very difficult to reconcile "independence" and "accountability".

The primary characteristic believed necessary to ensure accountability is "nailability" - the ability to hold the individual or group responsible for a bad decision. But this concept conflicts to some degree with agency independence. Few regulators can be removed from office (at least in the United States) without significant cause. Similarly, an agency should be flexible but its actions should be certain - again a difficult balancing act. Finally, the wish that the agency rely on the best experts available would reduce the weight placed on citizen input.

The array of controls that might be applied to a regulatory agency include the removal of the directors for various causes, control over the agency's budget, oversight and review of the agency's actions, limits on the terms served by the regulatory directors, and judicial review.

One major means of controlling the actions of a regulatory agency was seen to fall outside of government: the media. Reporters can and do track agency actions and write stories - sometimes exposés - when they believe an agency is abusing its position. The media and other watchdog agencies already play a key role in ensuring accountability.

The group discussed the value of gaining the views of the general public on specific regulations, but recognized that few individuals will have the time, the expertise or the inclination to participate in regulatory proceedings. Agencies have sought to address this problem by either creating "advisory boards" (appointed by the regulators) or providing funds to self-proclaimed citizen groups. It was felt that there is a great danger in that approach.

One idea floated at the conference (and largely rejected) would require regulatory agencies to submit their proposals (budgets and regulations alike) to Congress. Congress would be forced to take sides regarding specific regulation and would no longer be able to "have their cake and eat it too". Legislators would have to support or oppose each proposed regulation, just as they now have to support or oppose all federal spending.

Specific regulatory agencies - in particular those dealing with risk issues - have an internal-accountability problem. They are sometimes assigned responsibility for ensuring that no adverse consequences result from introduction of a product. Yet this ignores the risks associated with the absence of the product. Single-mission agencies, it was noted, can sometimes ignore the risk/risk choices facing society in the real world. Any effort to eliminate "conflict of interest" problems is almost certain to bias societal choices. It was noted that the Catholic Church had faced such a problem in its efforts to classify saints - and had resolved it by creating a risk/risk tribunal with individuals charged with vigorously arguing the case for and against sainthood. Few secular agencies, however, have adopted such accountability design features.

Areas Not Discussed at the Conference

The conference passed over a number of issues that deserve further treatment - possibly in future conferences. One is the tension between regulations and rights, now central to the wetlands-and-endangered-species regulations in the United States. Under what situations, if any, should regulatory agencies be forced to compensate those adversely affected by their actions? Property rights are given high priority; should regulatory agencies be allowed to ignore them?

Although past Ditchley conferences have addressed some forms of social regulation, the topic is vast and merits additional treatment. Privacy regulations, for example, now threaten the expansion of financial services based on consumer financial data bases. What rules should govern this policy area? Trade questions received considerable attention at the Conference but the topic is vast; the issue of extraterritoriality alone - should domestic rules be imposed on trading partners? - would easily occupy a conference.

Another area that merits further attention is the possibility that private self-regulation might play a much more significant role than it has to date. A wide array of private regulatory mechanisms - branding, warranties and guarantees, industry certification programs, insurance conditioned on specific performance - all exist and might well provide superior means of addressing some of the concerns that have previously been used to justify expanded political control of the economy.

The extent to which positive technological and institutional innovations might be inhibited by regulation received only passing attention at the conference. Yet such innovative changes are often an essential step toward increasing the competitiveness of an industry and thus reducing the task of the regulatory agency. Such innovations as the cellular telephone and money market funds weakened the case for continued regulation of telecommunications and banking respectively.

Conclusions

A series of regulatory case studies would be extremely valuable. There have been over time and across national boundaries a number of regulatory experiences, but most of these experiences have not been analyzed. Case studies could include structural variations

(AEC vs NRC); competing vs. sole-proprietary regulatory agencies; the intellectual and moral case for/against regulation. The case studies could include the history of various regulatory agencies, a critical assessment of their benefits and costs, ways in which agencies evolved, the roles of interest groups in operations of agencies, and the like.

The Ditchley Park discussion illustrated the extent to which shared views on the goals of a modern society could often coexist with sharp and disparate views on the wisdom of specific policies to advance them. That a group comprised of such a diverse array of individuals from various nations and professional backgrounds and

having more or less experience with the nuances of the regulatory state itself could nonetheless communicate and reach an understanding of why disagreements persist - even if not reach agreement on substance - speaks well of the strength of Western culture.

European participants were less familiar with the extent of regulation in the US and the extensive critical literature engendered by that experience. Two valuable suggestions were tendered: first, establish a more systematic effort to exchange notes; second, conduct a series of case studies to benefit from the diverse experiences of the various countries currently engaged in regulation.

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LIST OF PARTICIPANTS

Chairman: **Professor Giuliano Amato**, President, Italian Antitrust Authority; Prime Minister of Italy (1992-93); elected Deputy (PSI) for Turin-Novara-Vercelli (1983, 1987); formerly Under-Secretary of State, Presidency of Council of Ministers; Vice-President, Council of Ministers, and Minister of the Treasury (1987-89); Professor of Italian and Comparative Constitutional Law, University of Rome; formerly President, Aspen Institute Italia, Rome.

Mr William Bishop, Professor of the Economics of Competition Law, Collège d'Europe, Bruges (1994-); Chairman, Lexecon Ltd, London & Brussels (a consulting practice in economic and regulatory analysis)(1991-); Lecturer, Lincoln College, Oxford (1975-76); Lecturer, London School of Economics (1976-88); Visiting Professor, University of Toronto (1979-80); Visiting Professor, Monash University (1987); Visiting Professor, George Mason University (1987-89); Director, Putnam Hayes & Bartlett Ltd (1989-90).

Dr Colette Bowe, Chief Executive, Personal Investment Authority (1994-); Department of Industry: Economic Adviser (1975-78); Principal (1978-81); Department of Trade and Industry: Assistant Secretary (1981-84); Director of Information (1984-87); Controller of Public Affairs, Independent Broadcasting Authority (1987-89); Director, Securities and Investments Board (1989-93).

Mr D Rhett Brandon, Simpson Thacher & Bartlett (1980-), Senior Resident Partner, London office (1990-) (practice focused on international capital markets, cross-border mergers and acquisitions and US corporate law matters).

Mr John S Bridgeman TD DL, Director General of Fair Trading (1995-); Member, Monopolies and Mergers Commission (1990-95); Visiting Professor in Management, Keele University (1992-); Various management positions in Alcan Aluminium Group in Australia, Canada, Germany and United Kingdom (1966-1977); Vice President (Europe) Alcan Basic Raw Materials (1978-82); Divisional Managing Director, British Alcan Aluminium plc (1983-91); Director, Corporate Planning, Alcan Aluminium Ltd, Montreal (1992-93); Managing Director, British Alcan Aluminium plc (1993-95); High Sheriff of Oxfordshire (1995-96).

Mr Ian Byatt, Director General of Water Services (1989-); HM Treasury: Under Secretary (1972-78); Deputy Chief Economic Adviser (1978-89); Chairman, Economic Policy Committee of the European Communities (1982-85) (Member 1978-89); Member: Board of Management, International Institute of Public Finance (1987-90); Council, Royal Economic Society (1983-); Vice-President, Strategic Planning Society (1993-).

Mr Joseph F Condon, President, Condon International Group (strategic, marketing and investment consulting in the Russian Federation and the CIS) and Providence Capital, Russia (a private New York investment fund); Corporate Vice President, International Operations, Combustion Engineering (1978-91) (negotiated and established the very first American-Soviet Joint Venture and developed four other joint ventures including a \$2.2 billion petrochemical complex in Western Siberia); President, RJR Nabisco, Russia (1992); previously: Executive Director, American Chamber of Commerce in Russia; member: International Institute for Strategic Studies, London.

Mr Bernard A Courtois, Group Vice-President, Law and Regulatory Matters, Bell Canada (1991-); previously head of Ottawa office, law firm of Ogilvy Renault; admitted to the Québec Bar (1969), (to the Ontario Bar (1984)); a director: Tele-Direct (Publications) Inc.; Texacor Realty Management Inc.; Progisix-Solutions Inc.; the Ottawa-Carleton Research Institute.

Mr T Jefferson Cunningham III, Chairman and Chief Executive Officer, Hudson Chartered Bancorp, Inc; previously, Vice Chairman and Managing Partner, Kissinger Associates, Inc; Director: Kissinger Associates, Inc; the GGF Corporation; Advisory Director, Tarmac America Inc; previously: Area Director (Northern Europe) The Chase Manhattan Bank; a Director of Banque de L'Union Européenne, Marine Midland International Corporation, Chase & Bank of Ireland Ltd., E F Hutton Group Inc., European American Bancorp, P J Carroll and Company, Crocker National Bank, Financial Security Holdings Limited, Midland Bank plc, and Home Holdings, Inc. A past President, American Chamber of Commerce (UK) and Chairman, American Bankers Association of London; a Governor, The Ditchley Foundation.

Dean Ronald J Daniels, Dean, Faculty of Law, University of Toronto (teaches corporate law, securities and finance, mergers and acquisitions, and regulation of financial institutions); author; recently Chairman, Ontario Task Force on Securities Regulation, and a member, Toronto Stock Exchange Committee on Corporate Governance (The "Dey Committee"); Director, University of Toronto Electric Power Project; Chair, Corporate Governance Project.

Mr Donald W Davis, Retired CEO, Stanley Works; Senior Lecturer, MIT Sloan School; Chairman, Easco Aluminium Extrusions Company; Chairman, National Institute for Dispute Resolution; a Director, the American Ditchley Foundation.

Mr Nicholas Durlacher, Chairman, The Securities and Futures Authority (Director, 1987-); Chairman: BZW Futures (1992-); London International Financial Futures and Options Exchange (1992-) (Director, 1984-); Member, Stock Exchange (1970-); Partner, Wedd Durlacher (1972-86); Director: BZW Ltd (1986-); Investors' Compensation Scheme (1992-).

The Rt Hon Tim Eggar MP, Member of Parliament (Conservative), Enfield North (1979-); Minister of State, Department of Trade and Industry (Minister for Energy, 1992-, also for Industry, 1994-); European Banking Company (1975-83); Director, Charterhouse Petroleum (1984-85); Parliamentary Private Secretary to Minister for Overseas Development (1982-85); Parliamentary Under Secretary of State, Foreign and Commonwealth Office (1985-89); Minister of State: Department of Employment (1989-90); Department of Education and Science (1990-92).

HE Dr Paolo Galli, Ambassador of Italy to the Court of St James's; a Governor, The Ditchley Foundation.

Mrs Rosalind Gilmore CB, A Director, Securities and Investments Board; a member, Regulatory Board, Lloyd's of London; Chairman designate, Homeowners Friendly Society; Chairman, Arrow Broadcasting (a subsidiary of CLT); a Director: BAT Industries; Moorfields Eye Hospital; Opera North; HM Treasury: Assistant Secretary (1975-80); Press Secretary and Head of Information (1980-82); General Manager, Corporate Planning, Dunlop Ltd (1982-83); Director of Marketing, National Girobank (1983-86); Directing Fellow, St George's House, Windsor Castle (1986-89); reinstated HM Treasury, and seconded to Building Societies Commission (1989); Deputy Chairman (1989-91); Chairman/First Commissioner (1991-94); Chief Registrar of Friendly Societies (1991-94); Director of Regulation, Lloyd's of London (1994-96).

Mr Norman Glass, HM Treasury: Deputy Director (1996-); Exchequer and Audit Dept. (1979-81); Assistant Director (Micro-economics) (1995-96); Senior Economic Adviser, Department of Health and Social Security (1981-86); Assistant Secretary, Department of Health (1986-89); Director, Analytical Services, Department of Social Security (1989-92); Chief Economist, Department of the Environment (1992-95); Member, Economic and Social Research Council (1992-).

Mr David Harrison, Director of Corporate & Institutional Banking, Lloyds TSB Group plc (1995-); joined Bank of London & South America (1963); worked predominantly, both there and subsequently in Lloyds Bank International, in the eurocurrency market; responsibility for syndication of medium term loans, project finance and export credit (1970-75); overseas assignments in Brazil, The Netherlands and Portugal; most recently, General Manager, Risk Management, in London.

Mr Charles Henderson CB, Deputy Secretary, Department of Trade and Industry (1992-); Department of Energy (1974-88): Under Secretary Atomic Energy Division (1982); Oil Division (1985); Principal Establishment and Finance Officer (1986-88); Head, Office of Arts and Libraries (1989-92).

The Hon Peter Jay, Writer and broadcaster; Economics and Business Editor, BBC (1990-); Economics Editor, The Times (1967-77); Ambassador to US (1977-79); Director, Economist Intelligence Unit (1979-83); Consultant, Economist Group (1979-81); Chairman and Chief Executive, TV-am Ltd (1980-83) and TV-am News (1982-83); President, TV-am (1983-); Presenter, A Week in Politics, Channel 4 TV (1983-86); Chief of Staff to Robert Maxwell (Chairman, Mirror Group Newspapers Ltd)(1986-89); Supervising Editor, Banking World (1986-) (Editor, 1984-86); Director: BPCC, later Maxwell Communication Corporation (1986-89); Mirror Holdings (1986-89); Pergamon Holdings (1986-89); a Governor, The Ditchley Foundation.

Dr Robert W Jerome, Associate Director, International Management Program, University of Maryland University College, Graduate School of Management and Technology (1991-); Fellow, Economic Strategy Institute, Washington DC (Jan 1990-May 1991 full time; June 1991-present as adjunct); Executive Assistant to Under Secretary of Commerce for International Trade, International Trade Administration, Department of Commerce, Washington DC (1981-83); Vice President, Capital Strategy Research, Inc., Washington DC (1983-88).

Mr Anatole Kaletsky, Economics Editor and Associate Editor, The Times.

Mr John Kay, Chairman, London Economics; Visiting Professor of Economics, London Business School; fellow, St John's College, Oxford (1970-); Lecturer in Economics, Oxford University (1971-79); Research Director, subsequently Director, Institute for Fiscal Studies (1979-86); Director, Centre for Business Strategy, London Business School (1986-91); Chairman, Undervalued Assets Trust plc; Director: Foreign & Colonial Special Utilities Investment Trust plc; Halifax Building Society; Value and Income Trust plc; author.

Monsieur François Lagrange, Executive Director, European Investment Fund; Conseiller d'Etat; Chairman, Institut Français du Pétrole (1993-94); Vice-Chairman and Director, Crédit National (1985-92); Director, Banque Française du Commerce Extérieur and Compagnie Française d'Assurance du Commerce Extérieur (1985-93); Chairman, Sofinnova (1985-93); previously: Commissaire Adjoint au plan; Adviser to Minister of Industry and Research; Adviser to Minister of Economy and Finance, and Secretary General of the National Economic Accounts Commission.

Professor Paul W MacAvoy, Williams Brothers Professor of Management Studies, Yale School of Management (1991); Dean, Yale School of Management (1992-94); Member, President's Council of Economic Advisers, The Ford Administration (1975-76); Milton Steinbach Professor of Organization and Management, Yale School of Organization and Management (1977-81); Frederick William Beinecke Professor of Economics, Yale University (1981-83); Dean and John M Olin Professor of Public Policy, William E Simon Graduate School of Business Administration, University of Rochester (1983-1991); Member, Board of Directors: Open Environment Corporation (1993-); Alumax Corporation (1993-); Chase Manhattan Bank and Chase Manhattan Corporation (1992-); Lafarge Corporation (1993-).

Mr James Marshall, Assistant Auditor General, National Audit Office (1993-); Inland Revenue (1966-74); Office of UK Permanent Representative to European Communities (1975-77); First Assistant, UK Member of European Court of Auditors (1978-79); Assistant Secretary, Inland Revenue (1980-88); Consultant, CJA Management Recruitment (1988-89); Director, National Audit Office (1989-93).

Mr Roderick Paul, Group Chief Executive, Severn Trent Water (1988-95); BOC Plc: Business Manager, Tonnage & Bulk Gas (1969-73); General Marketing Manager/General Manager and Director, Afrox, Johannesburg (1975-77); General Manager, Gases, South of England (1977-84); Mitchell Cotts Plc: Chief Executive, South Africa (1984-85); Chief Executive (1985-87); Chairman, Environmental Affairs Committee, Confederation of British Industry.

Mr Brian Quinn, Executive Director, Bank of England (1988-); joined Bank of England (1970): Economic Division (1970-74); Chief Cashier's Department (1974-77); Head of Information Department (1977-82); Assistant Director (1982-88); Head of Banking Supervision (1986-88).

Mr Grant L Reuber OC FRSC, President, Canadian Ditchley Foundation (1989-); Chairman, Canada Deposit Insurance Corporation (1993-); Lecturer, Graduate School of Business, University of Chicago (1992-); Economic Adviser to Prime Minister of Lithuania (1991-92); Bank of Montreal: President (1983-87), Deputy Chairman (1981-83), (1987-90); Deputy Minister of Finance, Canada (1979-80); University of Western Ontario: Professor of Economics (1957-78); Provost (1974-78); Chancellor (1988-92); a Governor, the Ditchley Foundation.

Mr Alan Riddell, Secretary, Committee on Standards in Public Life (The Nolan Committee) (1994-); Private Secretary to Minister of State responsible for water privatisation (1987-90); Head of Housing, Private Rented Sector Division (1990-92); Civil Servant, Department of the Environment (1975-94) (Principal Private Secretary to Secretary of State (1992-94).

Mr Fred L Smith Jr, President and Founder, Competitive Enterprise Institute, Washington DC; writer and broadcaster; previously: Director of Government Relations, Council for a Competitive Economy; senior economist, Association of American Railroads; senior policy analyst, Environmental Protection Agency.

Mr Harry Swain, Special Advisor to the Minister of Finance; Deputy Minister of Indian Affairs and Northern Development (1987-92); Deputy Minister of Industry (1992-1995) (a department with policy and regulatory responsibility for telecommunications, standards, competition, intellectual property, weights and measures, and the electromagnetic spectrum).

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