Slack, Public Interest, and Structure-Induced Policy

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Michael Levine and Jennifer Forrence have taken on a prodigious task: to confer positive, predictive meaning on a thoroughly beaten dead horse, the "public interest" theory of economic regulation. The essence of their argument is that bureaucratic implementation of any policy entails some policy slack, which in turn enables an administrator some latitude in carrying out a legislative mandate. They then identify three conceptually distinct ways that this slack can be used: to serve a "special interest" (i.e., an electoral minority), to adopt a policy that a fully informed electorate would pass by majority rule (i.e., the non-Burkean "general interest"), or to pursue a policy that comports with some normative theory of the public interest that would not be acceptable to a majority of informed citizens (i.e., the Burkean general interest).1 They then proceed to develop a typology of conditions under which regulation will serve a special interest or reflect the public interest in either sense described above.

Our assessment of the Levine and Forrence article is that it is extremely

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1. A useful fourth category is that administrators simply do nothing, consuming slack by failing to perform. The value of this fourth category is that the theory of how policy evolves will differ according to whether bureaucrats simply do nothing or proactively pursue self-interest (such as maximizing their own wealth and power). Most of the economic theory of organization actually deals with the case in which an agent responds to slack by putting forth less effort.

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203
important, but perhaps not for the reasons they intend. Specifically, as contributors to the extensive literature on the economic theory of regulation, we recognize that no previous work has ever even remotely approached theirs in explicating with precision a positive public-interest theory. In fact, the theory's precision enables us to develop more fully its observational implications, and these are probably not what the authors intended. In particular, we seek to advance their work by showing, first, that the three different types of regulatory behavior are observationally equivalent with respect to policy outcomes, rendering their theory empty unless it is given more structure; and, second, that one mechanism for providing more structure is to develop more thoroughly their concepts of administrative slack and Burkean public-spiritedness. Section 1 provides an example demonstrating the observational equivalence of special interest, Burkean public interest, and non-Burkean public-interest theories. Section 2 incorporates slack and Burkean behavior into the theory of the political control of regulatory agencies.

1. THE EQUIVALENCE OF GENERAL-INTEREST AND PRIVATE-INTEREST THEORIES

One purpose of Levine and Forrence is to focus on the positive, predictive value of a public-interest theory of regulation, rather than its normative value. In particular, they do not believe that their non-Burkean test of whether a policy is in the public interest—that its adoption would achieve the support of a majority of a fully informed electorate—necessarily has meaningful normative content. A reader may infer from this line of argument that the principal message of the formal theory of democratic social choice is that majority-rule decisions lack normative value. Whereas the theory has this property, the inference is incorrect. Unconstrained majority rule also lacks positive, predictive value.

Beginning with the seminal work of Kenneth Arrow (1951), a 30-year research enterprise ended literally in chaos (see McKelvey, 1976). The principal result of this theory is that majority rule can lead to any economically and technically feasible policy outcome. Even if all voters are other-regarding, as long as they have differences in their preferences a sequence of votes can be constructed in which the resulting policy corresponds to the most rapaciously self-interested, special-interest outcome.

To illustrate this point, consider a simple example within the context of airline regulation. Assume that society contains $2N + 2$ citizens, divided into the following categories. $N$ citizens are elderly, $N$ citizens are young, one citizen owns and operates an airline, and the last citizen regulates the air-

2. Levine is a co-author of one of the important contributions to this literature (Levine and Plott). See also Cohen and Matthews (1980).
Price to Young

Price to Elderly

Figure 1. Alternative price structures available to an airline regulator.

We denote the first group by E, the second by Y, the third by A, and the last we call MEL. MEL's job is to set airline prices, one of which ($P_Y$) is charged to the young, and the other of which ($P_E$) is charged to the elderly. The legislative mandate gives MEL great latitude. Each price can be any nonnegative number, but the prices must be set so that the airline does not go bankrupt. MEL's only legislative instructions are to serve the public interest, convenience, and necessity.

Figure 1 depicts the policy environment of airline regulation. The line segment $\Pi_0\Pi'_0$ represents combinations of prices that cause the airline to earn zero excess profits. All price combinations above this line (up to limits not shown) produce excess profits; all prices below the line cause the airline to be bankrupt, and so are infeasible. Four prices are depicted in the figure: $P^*_Y$ and $P^*_E$ are the prices that maximize economic efficiency, and $P_{ME}$ and $P_{MY}$ are the monopoly profit-maximizing prices. Point A represents the airline's most preferred outcome, permitting it to earn monopoly profits. Group Y prefers that its own price be as low as possible and, hence, set to zero; however, this would require setting the price for the elderly at $P_{ME}$. In essence, the price combination ($0, P_{ME}$) extracts monopoly profits from group E and transfers them to group Y. Likewise, group E would like its own price to be zero, which would require a price of $P_{MY}$ for group Y. Finally,

3. Almost all similarities between MEL and any real person are purely coincidental.
point $Q_0$ represents the status quo, in which the airline earns a small excess profit and both prices are slightly above the prices that would maximize efficiency.

Changes in regulatory policy away from $Q_0$ result from interactions among the preferences of regulators and citizens, and the institutional constraints created by the regulatory process. Numerous policy outcomes are possible, depending on the goals of the regulator and the administrative requirements for undertaking a change in policy. For example, if MEL were a captured regulator, prices would be moved toward point $A$. This would increase airline profits at the expense of its customers. If MEL has enough slack, then despite the fact that $2N$ of the $2N + 1$ participants in the industry are harmed, prices can be moved all the way to $A$, and the airline can earn monopoly profits.

Suppose instead that MEL is a non-Burkean public servant, and has scheduled a meeting with the National Students Association. The latter proposes that MEL move prices to point $Z$. The effect is lower fares for the young, higher fares for the elderly, and higher profits for the airline because point $Z$ is further above the zero profit line than point $Q_0$. MEL investigates the matter, and finds that point $Z$ is preferred by group $Y$ and by $A$, and so commands majority support by a vote of $N + 1$ to $N$, with the elderly opposed. Hence, as a non-Burkean public servant, MEL adopts price structure $Z$.

Soon thereafter, the American Association of Retired Persons schedules a meeting with MEL, and proposes another new pricing arrangement, represented by $X$. Because $X$ lowers prices for the elderly and increases airline profits, it, too, commands a majority, and so is adopted by MEL. Finally, the airline approaches MEL, complaining of fare uncertainty. The airline proposes point $A$, the monopoly profit-maximizing level, and suggests that MEL put an end to fare investigations to avoid seemingly endless, unpredictable fare changes which serve only to confuse customers. Once again, because $A$ produces lower fares for the young than does point $X$, this proposal, too, achieves a majority. Following the airline’s recommendation, MEL adopts $A$ and then closes the regulatory agency to take a long vacation.

The point of the example is that both capture and majority rule led to the same outcome. In general, a regulator who uses slack to serve a special interest cannot be distinguished from another regulator who attempts to follow the dictates of majority rule. Of course, in this particular example, the actual policy outcome is ludicrous, because anyone would immediately recognize point $A$ as a special-interest outcome. But the reason that we know this is because we are using normative criteria that are external to the positive theory. We know that the point of regulation should not be to create monopolies because we have normative beliefs about the desirability of the
distributional and efficiency consequences of monopolistic outcomes. Nonetheless, these normative precepts have nothing to do with majority rule.

A third path for MEL is to be a Burkean public servant. At first blush, this appears to resolve the dilemma. Suppose that MEL is an unconstrained Burkean utilitarian who faces the status quo point \( Q_0 \) and any of proposals \( A \), \( X \), or \( Z \). MEL will then share the view that monopoly is undesirable on efficiency and equity grounds, and will adopt the efficiency-maximizing prices, \( P^*_E \) and \( P^*_X \) even if group \( Y \) and group \( E \) are unrepresented in the process. This interpretation, however, assumes that MEL shares the particular normative vision of the public interest described in the preceding paragraph.

Unfortunately, numerous normative theories of public policy may be embodied in the leadership of a regulatory agency, each of which produces a different Burkean outcome. For example, MEL may be a libertarian, and \( A \) may be a natural monopoly. If so, MEL will follow his Burkean nose and let the airline set whatever price it wants, resulting in monopoly prices at point \( A \). Once again, the adoption of point \( A \) cannot distinguish Burkean regulation from any other as long as there exists a normative theory which can be used to defend that particular outcome.

Even if MEL is a utilitarian, MEL's policy choices may not be unconstrained. Suppose, for example, that MEL can change the status quo only by adopting a price structure that has been formally proposed in a regulatory hearing. Then, the ultimate policy choice will depend on where the status quo is located and who is represented at the hearing. Suppose, for example, that the status quo is point \( X \) (favoring the elderly), and that only the airline has standing to participate in the rate hearing. In this case, monopoly pricing may actually be more efficient than point \( X \) and so be adopted by MEL as the best available alternative that can withstand judicial review.

The preceding example has been constructed for illustrative purposes, but its implications are completely general. It does not depend on the assumption that the parties pursue self-interest. It does not depend on the details of the particular example, such as the sizes of the groups or the fact that they use a simple, myopic voting rule (do I or do I not prefer the proposal under consideration to the status quo?). As long as no majority has identically the same preference, any feasible policy can emerge from a sequence of majority-rule votes. Hence, any position that is an ideal of a self-interested minority or that is the best outcome according to a Burkean criterion can be reached by majority rule. Thus, the typology proposed by Levine and Forrence, without further elaboration, presumes a distinction among the types of regulators that, as a practical matter, lacks predictive value. In short, one cannot tell by observing policy outcomes which type of regulator is in control.
2. SLACK, IDEOLOGY, AND POLICY STABILITY

Much of the research agenda in positive political theory during the 1980s was addressed to the conflict between the predicted chaos of majority rule and the observation that policies are relatively stable. A summary version of one attempt to resolve this inconsistency is that the details of institutional structure induce policy stability (Shepsle and Weingast). Our recent work emphasizes the role of administrative procedures as a means of inducing stability and predictability to the decisions of an agency.4 Our main purpose in this section is to link slack and Burkean behavior to our previous work, and to show how they add an important new dimension to understanding the political control of agencies.

A regulator can either be captured or consume Burkean policy change because elected political officials, and ultimately voters, cannot perfectly solve the problem of controlling the behavior of their agents. With respect to regulatory agencies, slack arises because neither elected officials nor voters are fully informed about the details of an agency’s actions and their consequences (McNollgast I) and because, in any case, they are unlikely to be able to restore the status quo if the agency deviates from the intent of its legislative mandate (McNollgast II).

We agree with Levine and Forrence that slack is inevitable (McNollgast I). Perfectly efficient solutions to a principal-agent problem are extremely implausible in the real world. We also agree that the amount of slack accorded an agency varies according to the circumstances surrounding the agency’s decisional environment.5 Levine and Forrence provide a list of factors affecting slack: self-publicizing political entrepreneurs calling attention to an agency’s actions, competition among politicians holding different visions of the agency’s proper role, other institutions that may attempt to pursue a general public interest (such as the media or broad-based political organizations like Common Cause), and even academic gadflies who study agencies and find them wanting.6 All of the examples provided by Levine and Forrence, however, are external only to the agency, but to the political decisions about its structure, procedures, and mandate. Thus, our first proposal for advancing the theoretical model put forth by Levine and Forrence is to consider that the degree of slack enjoyed by an agency is rationally chosen by elected political officials.

4. McCubbins et al. (1987, 1989), henceforth referenced as McNollgast I and McNollgast II.
5. See McCubbins (1985) regarding decisions to delegate broad authority to a regulatory agency, and Noll (1989) regarding the theory of the deviation of regulatory policy from even policies which could achieve unanimous approval.
6. A similar analysis of how these and other outside evaluations of an agency influence policy is the “external signals” theory of regulations, as explicated in Noll (1985) and Magat et al. (1986).
The ultimate source of policy slack is in the relationship between voters and the government. Slack arises because majority-rule representative democracy is itself an imperfect solution to the principal-agent problem; some variability in policy outcomes can arise without undermining the electoral security of office-holders. As argued by Levine and Forrence, elected officials value electoral slack because it enables them to sell policy to special interests or to pursue personal, other-directed policy objectives in a Burkean fashion.

Likewise, agencies will always have some slack, for legislation cannot embody a perfect solution to a principal-agent problem. But the value of slack to agencies can be directly at the cost of the value of slack to elected officials. Given a fixed amount of electoral slack, the scope of policy deviation by elected officials is constrained by the amount of independent deviation by agencies. If agencies have more slack, elected officials have less. Indeed, if agencies have too much slack, their policy deviation may be sufficient to pass the threshold at which deviations begin to have electoral significance. Thus, elected officials have an incentive to control agency slack, taking into account the cost of the methods used to control it (McNollgast I).

Levine and Forrence have provided the germ of an idea about one instrument elected officials might use to control slack. It lies in their observation that some administrative (and elected) officials may pursue Burkean public-spirited objectives. The problem with Burkean behavior is that a very large range of policy outcomes is consistent with other-directed preferences. The reason lies in the variety of normative criteria which might be used to develop a method for evaluating policy alternatives. In Section 1, we identified two such normative theories: Utilitarianism and Libertarianism. We can imagine many other candidates: Islamic Fundamentalism, Marxism, Trickle-Down Capitalism/Fascism, and Deep Ecology ("Earth First"), to name but a few. The form of Burkean consumption enjoyed by a bureaucrat would turn crucially on which normative criteria the bureaucrat was attempting to impose on society.

The second addition we propose for the Levine–Forrence theory is to take into account the fact that the elected officials who enact a policy will have preferences over the kind of administrator who will implement it. First, the winning coalition will not want someone who will sell policy to a special interest. Even if this outcome is intended by the enacting coalition, the coalition will want to receive the spoils from selling the policy. They will not want the agency to obtain the benefits of the sell-out. Second, the coalition will not want a non-Burkean administrator who seeks to pursue the public interest by performing thought experiments about fully informed majority-rule democracy. Elected officials will know that, in principle, numerous policies might command majority-rule support over the coalition’s agreement. But this does not make these policies either normatively compelling
or preferred by the politicians who have won the legislative debate over the policy. Thus, elected officials will seek to prevent infecting agency processes with the instability of majority rule.

The preferred administrator will be a predictable Burkean. Not any Burkean will do. It must be a Burkean who senses a personal normative imperative to do what the coalition wants. The advantages of such a Burkean are, first, that the winning coalition need not monitor the agency's behavior very carefully; and, second, that the regulator will be willing to take considerable public criticism without wavering from faithful pursuit of the coalition's objectives.7

The difficult problem for the coalition is to find the right kind of Burkean. The key is to explore the ideology of candidates to run the agency. One would expect, for example, that if one wanted to deregulate the airlines, one might select utilitarians and/or libertarians to run the Civil Aeronautics Board, which usually means selecting either economists or their running dogs in the legal community.8

One interesting implication of this line of argument is that it gives bureaucratic officials the illusion of independence (slack). After the fact, if the right Burkean has been selected, elected officials can ignore the agency. If the right administrator is in charge, the agency's actions will be consistent with the coalition's objectives, yet the agency will regard itself not only as independent, but, if the action is controversial, as a brave Burkean fish swimming against the strong tide of external disapproval. Nonetheless, the agency's independence will be chimerical; it is doing what the elected officials want, because its leaders have been selected to do so.

3. CONCLUSION

The primary purpose of our comment is to extend the conceptual model proposed by Levine and Forrence to take into account additional features of the political process. Both captured and majoritarian regulators are likely to produce policy outcomes that are undesirable from the perspective of elected political officials. But some Burkeans, constrained by well-designed deci-

7. The idea that regulators are selected on the basis of the policy preferences of elected political leaders is developed more fully in Calvert et al. They also provide a more specific definition of regulatory slack that is based on this idea.

8. McNollgast II contains another example, which was the debate in Congress over the provision in the 1977 Clean Air Act amendments regarding warranties for auto emissions devices. The issue was whether the Federal Trade Commission or the Environmental Protection Agency should develop the rules regarding maintenance procedures during the warranty period. Legislators favoring the EPA sought a policy that would be most effective in reducing emissions, whereas champions of the FTC sought to make certain that the warranty rules would not reduce competition in the auto-repair industry. These preferences between the agencies can be interpreted as a choice between two sets of Burkeans: environmentalists at EPA, advocates of competition at the FTC.
sion-making procedures in an agency, may, more or less automatically, pursue the policies that elected officials prefer. Hence, rational political leaders can be expected to use normative litmus tests in order to identify the “right” Burkean for an appointment to lead a regulatory agency. Moreover, if political leaders seek a dramatic change in regulatory policy, one should expect an equally dramatic change in the normative values espoused by the people who are appointed to the agency.

Transportation deregulation during the late 1970s proceeded in a way that is consistent with this expanded version of the Levine and Forrence theory. Changes in legislation underpinning transportation regulation took place considerably after the deregulation process had begun. The source of change was the appointment of new members to the Civil Aeronautics Board and the Interstate Commerce Commission who would energetically pursue a policy of reform (Derthick and Quirk). Similarly, new appointments at the Federal Trade Commission transformed a sleepy, inactive agency into an aggressive consumer advocate during the mid 1970s (Weingast and Moran).

We do not propose that choosing the proper Burkean regulator solves perfectly the principal-agent problem of political officials. To the contrary, we infer from the complexity of most administrative law that the best strategy for an enacting coalition is to use all of the tools available for preventing policy deviations by an agency. One especially obvious problem with Burkeans is that nothing can check their ardor for policies which are likely to seem extreme to pragmatic politicians. Nonetheless, in any policy context, some Burkeans are likely to be preferred to other administrative types. Moreover, if some policies persistently are implemented by agencies having few procedural constraints, we conjecture that in these cases delegation to predictable Burkeans will be common.

REFERENCES


