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Developing a Normative Theory of Fiducial Regulation

Barry M. Mitnick, Ph.D.

Professor of Business Administration and of Public and
International Affairs

Katz Graduate School of Business

University of Pittsburgh

261 Mervis Hall

Pittsburgh, PA 15260

Tel.: 412 648-1555

Mobile: 412 551-9956 (preferred)

Email: mitnick@pitt.edu

הפורום הירושלמי Jerusalem Forum
לדגולציה וממשליות on Regulation & Governance
האוניברסיטה העברית The Hebrew University
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ירושלים, 91905 Jerusalem, 91905, Israel
regulation@mscc.huji.ac.il :Email
<http://regulation.huji.ac.il>

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Abstract: The concept of capture is defined as referring to cases in which a regulated industry is able to control *decisions* made about that industry by regulators and/or *performances* by regulators related to the industry. It requires three conditions: essentiality and/or generality of the benefit, stability or persistence of provision of the benefit, and the public provision of defensive measures or actions that entrench the benefits against actual or potential challenges. Based on the literature of capture, twelve mechanisms claimed to facilitate capture are identified: Imbalanced affective access politics; substitutional governance; incentive-shaped individual decision making; information control and impactedness; competency myths; regulatory arbitrage; relational political governance featuring overhead agency controls and channel management; subgovernmental institutionalization; "Arational" regulatory process and instrument/tool design; implementation slippage featuring corruption, expedience, and/or identification processes; path dependence opportunism; and constitutional system biases. Those mechanisms, together with the logics that constructed them, suggest a number of principles for the design of regulatory systems that might avoid capture. These principles, in the form of normative propositions, are offered as the core of a speculative *normative theory of fiducial regulation*. The paper identifies several new concepts in understanding regulatory behavior.

Keywords: capture, industry protection, regulation, regulatory agencies, corporate political activity.

Acknowledgments: This paper was first in a series of papers that focus on the integration of descriptive theory about regulatory behavior in order to generate normative theory about regulatory design, and should be cited as January 2011. I wish to thank a number of readers/reviewers for comments on various products of this work.

Capturing "Capture": Developing a Normative Theory of Fiducial Regulation

It has been at least since Horace Gray (1940) and Merle Fainsod (1940) that scholars have warned that government regulation tended to serve the interests of regulated parties over more general public interests. Even though modern conceptions of the regulatory state are diverse and evolving (e.g., Jordana & Levi-Faur 2004), the uses of the state by private interests remain prominent features of regulation. A variety of political and bureaucratic processes have been said to be at the root of such outcomes. Huntington (1952) famously characterized the condition of the US Interstate Commerce Commission as a “Marasmus” in which the railroad industry successfully concentrated and defended regulatory functions within an independent agency strongly supported and influenced by that industry (cf. Kolko 1965 on the early years of the ICC and the critical historiographical literature it generated). Bernstein’s (1955) “Life cycle” model similarly focused on agency changes that occurred in the evolution of industry support for and defense of its regulation.

The label “Capture” has frequently been applied to such situations. A significant problem with the use of the term rests in its casual and sometimes conflicting uses. For example, “Capture” has been said to be present, variously, when “Regulatory agencies [are] captives of the industries they are supposed to regulate” (Gormley 1982); when regulators identify with the agency or become sympathetic with the agency’s problems or become lenient in enforcement (Makkai & Braithwaite 1992); when “Regulated groups were able to control or ”Capture” the agencies which regulate them” (Berry 1984); when “Regulated businesses can take advantage of economic regulation” (Marcus 1984, p. 73); “When organized interest groups secure regulation that advances their economic interests at the greater expense of citizens generally” (Croley 2011); or when “A single strong firm or industry group gets supportive regulation” (Teske 2004, p.37). So, does capture involve identification, leniency, sympathy, taking advantage, advancing an economic interest at the expense of the public interest, control, supportive regulation, or whatever “Captivity” means?

And these are only a few of a host of examples in what has developed as a decades-old literature.

The purpose of this paper is to analyze the concept of capture and the behavioral and organizational circumstances associated with it. After defining “Capture,” the article sorts the factors discussed by the literature as promoting capture into twelve mechanism categories. Such a categorization potentially permits the creation of a normative *theory of fiducial regulation*, which would allow us to identify a set of design principles, together with some speculative contingencies or conditions stated as propositions, that would permit regulatory systems to avoid capture. Based on the twelve capture mechanisms, the article concludes with some structured speculation about what some of those design principles and conditions are likely to be.

What is “Capture”?

The largely colloquial term “Capture” has served as an imprecise and encompassing label for a wide variety of causal factors, facilitating conditions and contexts, behavior patterns, and outcomes or impacts. The basic defining specification of Capture is that it refers to cases in which a regulated industry is able to control *decisions* made about that industry by regulators and/or *performances* by regulators related to the industry. In other words, the industry “Captures” regulatory decision making and/or performance so that what regulators decide and/or perform is what industry prefers they decide and/or perform. In short, industry is able to use regulation to steer benefits to itself over other potential targets of those benefits.

Government can provide many such benefits to the private sector, including contracts for services and products, favorable tariffs, forbearance of antitrust prosecutions, tolerance of monopoly or oligopoly, subsidies, favorable tax laws, generous decisions on allocations of public resources, adoption of rules that favor a company or industry over competitors, and so on. These benefits may come as a result of winning a policy battle with competing interests, or may become a permanent benefit locked into place by law and defended aggressively by public agents. Capture,

however, reflects a condition that goes beyond incidental influences, victory in particular policy contests, or even substantial and directly profitable public actions.

The concept of “Capture” in all its contexts usually requires three defining elements in addition to private control over an area of public decision making and/or performance in order to be recognized as capture: (1) Essentiality and/or generality of the benefit, (2) Stability or persistence of provision of the benefit, and (3) the public provision of defensive measures or actions that entrench the benefits against actual or potential challenges; such defenses can include the employment of institutional structures or processes that steeply increase the costs of detecting and/or intervening to oppose provision of those sequestered benefits.

In the first condition, capture is not usually appended to situations in which marginal benefits are gained, even if completely dominated by industry. A public utility that pretty much tells the state public utility commission how it will service outages has not captured the commission; The commission may still be negotiating the utility’s proposed rate increases. Moreover, the ability to influence public sector decisions in one’s behalf is not the same as the capture of those decisions. Capture presupposes control of a wide or general range of valuable, even mission-critical decision contexts; it is a *plenary* condition.

Second, capture is relational and stable. In effect, the benefited party has been absorbed as a participating member of the governance system. The behavior of that system will be seen as predictable, and other parts of the government will want it to be predictable in order to provide predictable interactions on which they can depend in doing their own work. If a private garbage contractor has captured the supply of trash services in its municipal setting, other actors will want to be able to depend on trash hauling being handled that way as they set budgets, deal with constituent complaints across other, Sometimes parallel and dependent service areas, consider wages for municipal employees, etc. In addition, the investment necessary to gain capture and maintain capture can be so significant that it will not pay private parties to expend it for time-limited gains.

Finally, it is critical that capture is a term definitionally applied to a relationship with the public sector; except in quasi-public cases, such as private,

professional licensing boards established formally as public agents, capture is always of public not private organizations. The key feature, one of its traditional characters, is that the public sector has a monopoly of force. The public sector is so attractive target not only because it has deep pockets of revenue and easy rationales of expenditure of that revenue, on what may be claimed are public purposes. But it is also especially attractive because the revenue that is extracted by mandate and the decisions to allocate the revenue or make laws or regulations that apply favorably to actors in the private sector are defended by monopoly of force. Government is a good partner to capture because it is likely to be able to both fulfill its promises as well as overwhelm any challenger. Hence capture will always use the powers of the public sector to defend the relationship and/or the continued receipt of the benefit by the favored actor. The defenses can be as simple as constructing what is functionally a levee in the form of the complexity and costs of monitoring for such channelled benefits, and the costs of challenging their provision via the formal administrative process (cf. Mitnick 1981/1993, Levine 1998).

Even if an industry controls regulatory decisions, it may not be able to completely control the behavior of the bureaucratic regulators who implement the decisions and who interface with the industry and to control all contexts of regulatory delivery. This is a common observation in the literature on public policy implementation (e.g., the classic work of Pressman and Wildavsky 1973[1984]; see also, e.g., Mazmanian and Sabatier 1983). On the other hand, decisions by agency leadership may be little more than symbolic if lower-level regulatory implementation is controlled or systematically influenced by the industry (cf. the situation of state vs. federal strip mining inspectors in some states in the 1980s; Mitnick 1982). Thus, control of decisions, and control of performances are empirically distinct phenomena, and capture may apply to one or both of them.

Complicating the analysis is the fact that regulatory performances do not always produce the outcomes intended by the regulators or by others who control those performances. It follows that an industry that seems to capture regulatory decisions and/or regulatory performances may not always achieve the protective benefits that such control should provide. As already noted, implementation issues can intervene and produce effects not intended by any of the participants. Thus, one

cannot reason backward from impacts to capture, i.e., one cannot confidently infer that “capture” was or was not sought and produced on the sole basis of the impacts of regulation.

Finally, even when industry is able to fully control both regulatory decisions and/or performances and achieve the outcomes intended by such control, there may be no necessary conflict with the public ends espoused by the regulation; public and private interests can conflict, coincide, or overlap (for a discussion, see Ayres & Braithwaite 1992; for a discussion of public interest theory in regulation with comparison to other approaches, see Kalt & Zupan 1984; Levine & Forrence 1990; Croley 2008; Christensen 2011). Indeed, the appearances of capture may be unacceptable even when its actual outcomes are not controversial (cf. Mitnick 1975).

Social constructions of “Capture”

Issues arise when apparent control of the decisions and/or performances that benefit industry steer regulatory actions away from either the behaviors or the outcomes expected by; the legislative creators, legislative or executive overseers, or judicial reviewers of the regulation, or produce variance from public expectations of how the regulation is supposed to perform. Thus, the uses of “Capture” as a connotatively negative, colloquial term reflect what are essentially social constructions of the regulatory process both by formal public agents concerned with regulation, and by public observers of the regulation (on social construction and on the social processes of “framing,” including framing public policy, see, e.g. Berger and Luckmann 1966 on social construction; also see Weick, 1995 on sensemaking; Fiske & Taylor, 1991 on social cognition; and a very large literature on “framing,” including many works on the framing of public policies and public programs, the conduct of public relations, and the construction and presentation of reputations, e.g., Callaghan and Schnell 2005; Chong and Druckman 2007; Druckman 2001; Goffman 1974; Hallahan 1999; Mahon and Wartick 2003; Nelson and Oxley 1999; Tversky and Kahneman 1986; on perceptions and regulation, see Gormley 1982).

Those constructions are typically interpretative and often reflect degrees of ignorance about the formal requirements of the regulation and about actual conditions

in government and in the individuals/firms/industries subject to regulatory controls. Regulation is most often not plenary; it is aimed at restricting the choices of behaviors by particular classes of individuals, firms, or industries, rather than taking on the general behavioral and relational restrictions reflected in common and black-letter law in such contexts as contracts, agency, or torts. Because regulation is specific rather than general in application, it reflects the particular technical conditions and behavioral peculiarities of the target classes of individuals, firms, and industries. Design of the regulation, and understanding of its functioning by observers, requires information about, and expertise in, those target classes that is fundamentally costly to acquire.

Lacking that informed understanding, observers of regulation are likely to create social constructions of the nature and performance of regulation, regulatory agencies, and regulators; that are at variance with those created by those with such familiarity. This disjunction extends to perceptions of regulatory capture, and can work in both directions: Observers can believe that regulation is functioning as legislatively intended and designed, when it is actually protecting industry, and observers can believe that regulation is corrupt and serving industry ends when it is actually malfunctioning for reasons not strictly due to industry control of regulatory decisions. This can in either case have the effect of postponing or misdirecting needed reforms.

Complicating the understanding of capture relationships is that many features of them are inevitably covert. By their nature, capture relationships can involve sequestered provisions of benefits to particular individuals in government, and to particular individuals, firms, or industries in the private sector. Although the benefits transferred and the relationships established, may in fact be perfectly legal (cf. “legal corruption,” below) it is unlikely that transparency for these transfers will be viewed with positive affect by the observers outside the relationships. Moreover, the transfers often come at a redistributive cost; they represent wealth that the public sector, as well as the private sector, might direct elsewhere.

Hence, systems with capture typically feature stability-enhancing institutional protections to retain and defend against challenges to that capture. These may include control of the legal approaches to challenge, or the construction of exceptionally

costly such approaches. And, as noted, the social construction of the benefit system may be cloaked to avoid any challenges at all.

Mechanisms of capture

Capture is not a simple concept, involving easily-explicated social behaviors; it is not a straightforward case of public corruption, in which certain parties simply capture, by legal or illegal means, rents that are then protected by state action. Capture should be understood as a complex set of behavior patterns and relationships that can be produced in many ways, often acting in concert with one another. The literature in this area is now vast, and growing, and it is not possible in this space to present an inclusive review (for a thoughtful recent critique of the literature on capture, see Croley 2011).

But the literature has so far lacked not only a consistent definition of what is and what is not capture, it has also generated a confusing mix of mechanisms said to facilitate capture. In what follows, I have sorted a number of the important approaches to treating capture, generalizing their key aspects. If we are to develop a robust theory of capture, it is essential to not only recognize such alternative paths to capture, but categorize them.

Each of the mechanisms below is abstracted from models and/or research streams in the literature. Besides providing understanding of the range of mechanisms that can contribute to capture, such an approach can also be suggestive of policies that could inhibit the production of capture. For that reason, I have deliberately excluded or simplified models that do not provide descriptive theory; positive approaches that incorporate extreme simplification (e.g., assuming that all regulators are elected) can sometimes find interesting empirical support, but are markedly less valuable in trying to design actual policy solutions. It is certainly possible to learn much from “as if” assumptions, but in disagreement with the well-known position taken by Milton Friedman, finding that a model predicts well does not tell us much about why that happened, and whether the result is really a proxy for how actual behavior occurs.

Regulatory programs are embedded in an institutional field that can feature:

- *Imbalanced affective access politics*, such that streams of biased demands, conveyed via multiple advocacy channels, overwhelm competing demands, and impact both political and administrative decision making processes;
- *Substitutional governance*, in which turnover in role incumbents operating in an incentive-biased and affectively skewed environment shifts behaviors, or other substitution effects lead to biased governance;
- *Incentive-shaped individual decision making*, in which incentive systems mediated by regulated parties, and facilitated by institutional opportunities, shape the decisions of key actors;
- *Information control and impactedness*, in which regulated parties control and filter information essential to regulatory decision making, in which the competitive supply of alternative information is costly, or in Williamson's term (1975), *impacted*, and in which the public supply of information is actively managed;
- *Competency myths*, in which agency reputation, together with the legal mandates of scope of review of administrative action, establish and defend the myth that deferral to regulatory decisions is required, even if those decisions protect parochial interests;
- *Regulatory arbitrage*, in which advance commitment of regulatory objectives, structures, tools, budgets and other resources, coupled with the process and political constraints of acquiring additional resources and altering regulatory controls and implementing structures in the public sector, provide opportunities for the regulated actors to gain advantaged and protected statuses;
- *Relational political governance featuring overhead agency controls and channel management*, in which political overseers of regulatory agency behavior establish and manipulate a variety of agency controls (e.g., budgets, legislation, reputations of regulators). Also manage those channels of control in ways that protect their constituencies;
- *Subgovernmental institutionalization*, in which the system of policy making becomes a closed system in which certain players, and not others, are legitimated; and

in which the system features expectations regarding demands, specific role incumbents, negotiating practices, alliances, and so on.

- *“Arational” regulatory process and instrument/tool design*, in which the design of and mandates associated with the regulatory process, and the choice of regulatory tool, confer significant comparative advantages and benefits to certain regulated parties over others affected by the regulation;
- *Implementation slippage featuring corruption, expedience, and/or identification processes*, in which implementing regulators take bribes, economize and simplify regulatory tasks in cooperation with the regulated industry, and/or become identified with the regulated parties;
- *Path dependence opportunism*, in which system change occurring in a discontinuous manner and without centrally rationalized monitoring and governance, permits some actors to seize control of and erect publicly-managed defenses around significantly beneficial resource flows; and
- *Constitutional system biases*, in which formal system rules have the effect of conferring comparative benefits on some over other actors.

Although it is the interaction of these processes that produces the many manifestations of capture, for the sake of beginning a process of systematic theory-building, we will approach each area as *ceteris paribus*.

- *Imbalanced affective access politics*: Among the oldest contributions in the streams that discussed capture are works that observed that “parties-in-interest” operating as “pressure groups” seemed able to push political systems toward biased public decision making. Using “access” points located across governmental institutions, such groups acquired and defended positions of “power” at the expense of groups lacking the resources or ability to effectively compete for influence. Those dominant groups generated streams of biased demands that competed with one another through the governing process as well as continually steered public sector behaviors to satisfy those demands. Classic works by Fainsod (1940), Gray (1940), and McConnell (1966)

discussed how biased groups gained power; questions of who has power and how to limit power often dominated discussions (on power and corporations, see Epstein 1969). Politics itself was understood in terms of a process populated by groups rather than in terms of formal institutions (e.g., Bentley 1908, Truman 1951).

Later works questioned whether any groups could really sustain such dominance. The pluralist school (e.g., Dahl 1961) argued that politics was really agent-led; groups were not groups but actually small circles of active elites that acted as agents for their group constituencies. The institutional rules, enforced by republican elections, forced the elites to circulate, competing to replace one another as effective controllers of state power. Because the elites circulated instead of dominated, state power would not be systematically biased and steered over time to benefit only parochial interests.

This view of government as self-correcting system was challenged by empiricists who observed that, in fact, some groups never even participated in the circulation (e.g., Bachrach & Baratz, 1970; for a clear exegesis of the arguments here and above, see Cobb & Elder, 1972). The issues of concern to some interests never even reached the agenda for government action, much less had their days of influence and rotated out of power. Democracy in practice was a convenient myth that provided cover for control by a small set of interests that indeed manipulated the tools of power in their self-interests. Government programs, including regulatory ones, that served some interests over others were, in effect, captured by the benefited parties.

It is difficult to extract a systematic and consistent theory statement from the older literature on pressure groups and power; “pressure” is a vague term; even consideration of the nature and boundary of a group can invite debate. Although all politics may be seen as “process,” we are left with a vague notion of exactly what “process” is. Moreover, The literature is far from a coherent body; it contains works making conflicting claims about the outcomes of group action, even as they all employ groups as the focus of their analyses. Although some scholars worry that some kinds of groups; groups with privileges that other groups do not have, groups with resources, larger groups, groups able to access government better, or groups with more effective advocates, can bias policy to the extent of producing “Capture.” others distinguish the undue influence of successful pressure groups from the stable

domination of “Capture” (cf. Gormley’s discussion, 1983). Thus, at the risk of not capturing the richness of the analysis in the classics in this body of work, I’ve chosen to both offer a narrow interpretation, sidestep some issues, and leave some aspects undefined.

In order to avoid a lengthy tour of a complex literature, I will leave “power” as an essentially undefined term. Of course, Dahl’s (1957) definition (in essence, getting one party to do what the other wants) is one of the most cited, and close to our treatment of capture itself as a descriptor of cases in which industry is able to control regulatory decisions and/or performances so as to do what the industry wants. The basic claim in this literature is that groups that dominate political processes so as to bias processes and outcomes, acquiring and defending power at the expense of competing groups, are more likely to capture regulation.

Extracting some basic points in common, I term this general approach, *imbalanced affective access politics*. The modifier *affective* is used to reflect clear bias, i.e., strong preference for or attachment to one position over others in requests for government action. The scale on which groups contend is not balanced -- some groups are consistently more powerful than others. Another, similar, metaphor is that of the tilted playing field, though that metaphor takes the institutional context as the source of the bias (see the discussion of capture via constitutional system biases, below), rather than the power of the groups themselves. Decisions occur via groups using the political process available to them at various access points to dominate; the outcomes are not determined via formal institutional rules.

One theoretical problem that comes from employing this perspective to elucidate the mechanisms of capture is that “pressure” becomes a catch-all for what more powerful groups can do. In fact, using a phrase such as “powerful pressure groups” verges on tautology -- the effectiveness of “pressure” comes, after all, from the group’s sources of “power.” That’s why we sidestep things by relying on a biased demand, i.e., specifying “affective,” by specifying that the sides are not equal, i.e., that they are “imbalanced,” and by citing a particular process focus by noting an emphasis on “access politics.” I chose to use the modifier “affective” instead of “biased” in order to remove potential confusion with “imbalanced.”

In what may be seen as a later clarification in how pressure groups become successful, Wilson (1974, 1980) pointed out that the distribution of costs and benefits can have critical effects on the success of attempts to bias public policy. Especially where the costs are distributed diffusely but the benefits concentrated, those seeking favors from government may be more likely to be successful. Although intuitively appealing, an argument like this still requires mechanisms -- systematic logics of access and benefit conversion -- within the black box to transform opportunistic, imbalanced pressure to actual benefits.

One mechanism that attempts to repair affective imbalanced access politics uses formal agents to substitute for pressure groups, in order to try to re-balance the influence competition. They are sometimes termed “proxy advocates” (also, “special merit” or public interest counsels; “consumer advocates”), though the role of substituting agent need not be a formal institution of government (on these roles, see, e.g., Mitnick and Weiss 1974; Berry 1984; Gormley 1982, 1983; Holburn & Vanden Bergh 2006). Proxy advocates require at least three features in order to be successful: information/expertise in the regulated industry; legal and preferential access; and recognition as substitute players, i.e., as legitimate agents of the interests in question. In particular, proxy advocates solve the agency problems of diffuse groups, and appear to be employed as a way of using their formal role to sustain the re-balancing advocacy when electoral or other political support is expected to weaken in the future (Holburn & Vanden Bergh 2006). Proxy advocates or “special merit” counsels ensure that the benefits of revelation and rationalization via the process of adversary discovery and debate continue to characterize the administrative process (on the reduction of bias via adversary presentation, see, e.g., Thibaut, Walker & Lind, 1972; on the undesirable consequences of “adversarial legalism,” see, e.g., Kagan 1991).

- *Substitutional governance*: A major, repeatedly employed theme in explanations of capture relies on replacement of neutral governance by new, stable, and biased role incumbents. The term “revolving-door” describes one source for the members of the new regime, the regulated industry itself. Industry members presumably come with a particular inclination to serve their industry, together with a sophisticated understanding of the kinds of public actions that would do exactly that. And the

revolving door phenomenon provides a second explanation for bias: Because the regulated industry has an interest in employing able regulators with advanced understanding of the regulations (e.g., Quirk 1981, pp. 170-172; Kohlmeier 1969, pp. 73-74) and of both the formal and informal contexts in which regulatory decisions are made, they can proffer remunerative positions to term-limited and/or ambitious regulators. The assumption is that the blandishment of opportunities for lucrative future employment would temper regulators' interests in making decisions with stringent impacts on the industry (see Noll 1971, Mitnick 1980, Quirk 1981, for discussions of these arguments; there is also a small literature over a couple of decades that has documented the occurrence (or absence) of the revolving door in a variety of regulatory agencies; for examples, see Gormley 1979; Krasnow, Longley, & Terry 1982; Skrzycki 2003; but cf. Freitag 1983). Makkai and Braithwaite (1992) identify three capture-related aspects of the revolving door: industry identification; lack of toughness in regulating; and sympathy with the industry's problems. They conclude from their study of Australian nursing home inspectors that the revolving door by itself is too simplistic to offer as a cause of capture; the problem is better understood as situational. I will argue that the revolving door problem is better understood in the more general context of generation of biased governance.

The existence of the revolving door in some agencies does have significant empirical support, though the empirical results vary by agency, by level of regulator, and by definition of prior or future service; the problem comes in determining how much of a difference it makes. Serious questions have been raised of whether even revolution into and out of the regulated industry really affects policy (e.g., Quirk 1981; Gormley 1983). As noted, it makes sense for firms to hire active, competent regulators; they would be far more useful than those whose ability or commitment to the organization may be questionable. Furthermore, although much less so today in the US than in past decades, many senior regulators continue to be lawyers. For them, post-regulator employment rewards can be enjoyed by cashing in on both their network contacts and experience gained while in regulation. That can involve hiring out to the regulated industry or even to potential competitors or other parties with interests in the industry. Thus, it is the *regulatory capital* (in analogy to social or human capital) that regulators gain from their time as regulators that has the true value

for them, not some posited accumulated bias on the job or for particular kinds of remunerative work after it.

Note that the revolving door really suggests a generalizable situation that is not necessarily linked to particular institutional revolving doors, and even to particular incentives for biased decision making (i.e., future employment). The basic aim of capture in this general case is to replace neutral with biased governance. There are many forms that this can take: Biasing existing regulatory managers via incentives; replacing neutral agency managers with biased ones; cutting line regulators so that enforcement becomes delayed and problematic; reducing the level of regulatory expertise in the agency by forcing out experienced regulators, making it less likely that regulatory violations will be recognized and enforcement actions taken; relocating regulators so that they cannot detect violations; delegating regulation to other governments less likely to enforce the regulations because they are more politically sensitive to the regulated industry or less able to enforce them; and so on.

Thus, the US federal government's policy of *primacy* delegates implementation of federal regulation to state governments that have adopted, via legislation or regulation, rules that are judged sufficiently similar to the federal ones. Federal regulators withdraw, sometimes only to provide expert consulting to state regulators or to inspect the most potentially problematic work sites, such as large steel mills or oil refineries. But state regulators can have lower salaries and less professional training than the federal regulators (at one time the differential was striking in some regulated areas; see Mitnick 1982). Furthermore, local and state officials are likely to be more sensitive to the interests of large companies in their regions and communicate that concern to state regulators, than would be the federal regulators. Thus, even while oil was still flooding into the Gulf of Mexico from the massive BP Deepwater Horizon oil spill, state officials in Louisiana were complaining about the Obama administration's suspension of deep water drilling. Fearing the loss of tens of thousands of jobs, they were responding to widespread public support for oil drilling in the Gulf (see, e.g., Eaton, Ball & Power 2010; Bastillo 2010).

- *Incentive-shaped individual decision making*: Literature in this area assumes that regulators are rational in the sense of acting consistently with respect to their goals, and will alter their decisions and influence regulatory performances in response to the

provision of incentives that encourage such behavior. It adopts methodological individualism so that collectives such as organizations are treated as unitary actors; they are what their directing managers are. Decisions made by those managers are the collective's decisions; there are no issues of implementation, no complexity of joint action. In addition, the usual assumption, often implicit, is that those managers are self-interested. To the extent that the managers are treated as indistinguishable from the organization, that self-interest becomes the same as the organization's interest.

Most of the institutional/organizational features that structure behaviors are assumed away, with authors relying on the "as if assumption" associated with Milton Friedman's arguments regarding positive economics. For example, Peltzman (1976), building on Stigler (1971), even treats regulators as if they had been merged with legislators and have the same motivations for reelection, an assumption that is in most cases descriptively incorrect. But even simplified models require some institutional framework in order to generate predictions. Thus it is common to assume that legislators are vote-maximizing and seek campaign contributions in order to repeatedly win elections, that regulators receive budgets from the legislatures, and so on.

The self-interest assumption can lead to some shaky logic in setting up the motivations to which incentives are directed. Thus, regulators are assumed to want things like an easy managerial life while they are regulators (see Eckert 1973) and lucrative employment when they leave the agency, but those who send them incentives are assumed to have only the firm's or industry's interests as their goals. In other words, the regulators are assumed to be imperfect agents, but their influencers are somehow able to perform as perfect agents. This is logically inconsistent. Moreover, there is no particular reason to assume that regulator motivations will be different from those in the appointed public service and those in the civil service, except for the specific instances in which the task of regulation differs from other governmental tasks. For example, more than government workers in general, regulators are often extremely dependent on the industry for information needed to regulate, and sometimes can find rewards in post-regulatory employment (see the discussion of the revolving door, above). Conceivably, active manipulation of such aspects could influence regulatory decision making. But we still lack a good logic that

suggests how influence agents can overcome their own agency problems. Indeed, an argument could be made that any bias that regulators acquire from depending so much on industry information is the result of the institutional structure of regulation that naturally relies on information framed by the industry for its own use, and not of the deliberate sending of biased information to regulators by the industry.

An abbreviated summary of the individualistic incentives model that is said to produce capture -- the so-called "iron triangle" that aligns the interests of industry, legislators, and regulators -- goes as follows (see Noll 1971; Mitnick 1980; Mitnick 1991/1985): Legislators serving on committees of oversight of the regulated areas (because that regulated industry is relevant to their district) seek to be reelected. They need votes and money. The industry in their district can generate both, in part through mobilization of district interests that are common with the industry's. The legislators thus act to further and protect the industry's interests. The legislators control the agency's budget (usually at least partly descriptively false), can generate regulatory directives via new legislation (or steer interpretations of existing legislation by threat of new legislation), and can embarrass peak regulators by holding oversight hearings that expose management and regulatory conduct issues. Such hearings threaten *regulatory capital* -- regulators won't be able to offer competence and network contacts to future employers. Thus regulators will be especially responsive to legislators and, indeed, will rationally try to anticipate their wishes, rather than suffer the costs of learning those preferences as a result of legislator interventions to steer regulator behaviors back to what the legislators prefer.

Regulators continually require large amounts of idiosyncratic information from the regulated industry in order to perform their regulatory tasks. Knowledge about the industry, and about the situations of particular regulated companies, is highly specialized and costly or impossible to obtain from sources other than the industry. There are few competing suppliers of information that would have either an origin biased other than the industry, or reputedly more objective than the industry. The regulators engage in extensive personal interactions with the industry, gain knowledge of industry networks (part of their regulatory capital), and come to see industry managers as decent people trying to be successful. Regulators attend industry association meetings at which they are honored and feted; they receive such positive

attention from nowhere else (for examples, see Kohlmeier 1969). Regulators learn of ways in which their regulatory capital can become valuable to them in the future, such as in jobs in the industry or dealing with the industry.

The outcome is capture. Legislators do what industry wants. Regulators do what legislators want. Regulators come to see the world as the industry sees it, develop non-adversarial relationships with industry, recognize personal opportunities in the future, and, eventually, do what industry wants regulation to do.

Later theoretical and empirical research (e.g., Mitnick 1991/1985; Quirk 1981; Berry 1984; there are a number of others) has challenged the inevitability of this logic. The recognition of the importance of participation of other actors as regulatory stakeholders, such as citizen groups (e.g., Mitnick 1991/1985; Ayres & Braithwaite 1991, 1992); formalized consumer representatives (e.g., Mitnick & Weiss, 1972; Berry 1984; Holburn & Vanden Bergh 2006) or “proxy advocates” (Gormley 1982, 1983); maintenance of strongly supportive pro-regulation constituencies (Sabatier 1975); courts willing to go beyond traditional grounds for scope of review; interventions by peak political executives when regulatory crises occur; professionalization in the agencies; dependence on adequate resources, such as overall budget and technical expertise, and so on; suggests the importance of developing systems models marked by contingent effects.

A strict self-interest assumption is not really necessary to build all these arguments; the extreme simplification is often necessary to formalize the statement of the argument, but with serious losses in the quality of descriptive theory provided. Institutional theory approaches as developed in the sociology and management literatures can incorporate incentive systems as central explanatory features (see, e.g., one of the works often considered foundational in institutional theory, DiMaggio & Powell 1983). Moreover, what is needed in many cases is only a simple rationality assumption, together with a careful specification regarding the goals of the target actors and the cognitive biases that govern their perceptions of reward-seeking. Nor is it strictly necessary to adhere rigidly to methodological individualism; rational actors can be embedded in more realistic, complex organizational settings, and still respond to incentives within the structures and constraints of those surroundings. Thus, we can acknowledge that peak managers respond to incentives and affect what

their organizations do, without assuming that incentive effects operate on them as individuals in isolation.

- *Information control and impactedness*: In general, the regulated parties control and filter information essential to regulatory decision making, and the supply of alternative, potentially competitive information is costly, or, in Williamson's term (1975), *impacted*. Hence, the capture of information can be equivalent to the capture of the meanings applied in interpretations made as part of regulatory decision making, and, ultimately, to the capture of the process itself.

Technical information can be the source of both quality decision making, and defense of decisions that favor some interests over others (Sabatier 1978, Sabatier & Whiteman 1985; cf. Jenkins-Smith & Weimer 1985 on "analysis as retrograde action"). Gormley (1986) argues that when technical complexity is high, and accessible largely to the regulated industry, and the salience of the affected issues to the public is relatively low, capture is promoted. If only because of the agency problems involved, government can never be as technically expert as the industry it regulates. Although public interest groups have served as alternative, competitive sources of policy analysis, they cannot fully substitute for industry's constant attention to the details of its own work. Hence, because both regulatory policy making and enforcement rely so heavily on technical analysis and reporting, industry can shape regulatory decisions through information control. There are, however, familiar, seriously-advanced historical arguments in both the public utility and public enterprise literatures that permitting government to operate and/or manage enterprises similar to those in the private sector can supply it with critical information on costs and other benchmarking information that could inform regulation of the same industry. The literature also argues that behavior in legislatures that provide critical oversight for regulation may be driven by the sources and availability of reliable information, and affected by the information flows among the participants in policy making, including legislative committees, administrative agencies, interest groups, and other third parties (cf. Hamm 1983; Krehbiel 1991; Battista 2009).

In regulation, it has long been argued (e.g., Porter & Sagansky 1976; Mitnick 1981/1993; Mitnick 1980, 1991/1985; Gormley 1983) that control and strategic manipulation of information can both shape regulatory decisions and outcomes, and be used strategically in competition in regulated industries. Such manipulation extends to the management of information flows to the media. Thus, the methods of issues management can be used to redefine the nature of the benefits received from regulatory decisions and/or performances. For example, supra-normal profits from regulatory protection can be redefined as incentives toward and/or necessary resources toward producing necessary levels of research and development or innovation that will serve societal interests (e.g., in pharmaceutical pricing). The outcome of such information control can, of course, be protection of an industry, and sustenance for capture.

- *Competency myths*: The classic rationale for delegation to administrative agencies is that they would be populated with a permanent staff expert in the area of regulation and would perform their delegations insulated from corrupting political pressures (see, e.g., Landis 1938). The legislature would lack both the time and expertise to develop detailed rules to implement regulatory mandates, and so would be obligated to entrust these essential legislative duties to the agency -- it was indeed an *agency*. The strictures of judicial review of administrative action sustain this rationale: Courts of review are loath to substitute their judgments for those of the agency if the agency considers all the issues its regulations and the law says it must, and assembles a substantial record reflecting its expert consideration of the case. The ritual of judicial review displays features of what has been labeled “social proof” (see, e.g., Rao 1994; Rao, Greve & Davis 2001): Credibility that the decision is proper is assigned by the collectivity not on the basis of the actual rationales being compelling, but on social recognition of procedure-following.

The superior expertise of the delegated regulatory agent is one of what I will term *competency myths*. Such myths are necessary to operate coercive systems of regulation that are typically under-resourced; where knowledge linking regulatory controls to impacts is often tenuous; where decisions must sometimes be imposed in fractious environments in ways that suggest that that they will be sustained on appeal;

where regulation occurs in a distributed, sometimes conflictual environment in which control of the same industry is spread across multiple agencies handling multiple aspects of the industry's behavior; and/or where the agency's competence and effectiveness must be hyped in order to guarantee compliance.

Competency myths are particularly essential when the subject of regulation involves intangibles that cannot be directly validated by consumers (e.g., "credence goods") and in the opposite extreme in which the subject of regulation is so technical and/or abstruse that it requires certification by qualified interpreters of its technical content.

For example, for decades the US Securities and Exchange Commission was considered one of the best performing of US commissions, among a group of independent agencies that were widely considered mediocre by critics of regulation. Although the securities industry could hardly be considered to be continually supportive in all respects of Commission policies and actions, the industry was said to understand that the "level playing field" that the Commission provided via effective enforcement generated trust in investors -- trust in what was an industry not of steel or trade or pharmaceuticals, but of intangibles (on the SEC as a "symbolic guarantor of trust," see Shapiro 1984). That is, the very nature of the industry meant that its products could often not be easily or directly examined to determine that they were what they claimed they were -- they were "credence" goods (Darby & Karni 1973), and thus the market would benefit if there were a means to attest that the valuations assigned by the market to them could be reasonable and reliable. Given the opportunities for fraud provided by such products, there was a very functional role for the SEC to in effect certify filings by regulating them and maintaining an enforcement mechanism. Thus, it was essential to maintain the myth that SEC enforcement was truly effective, despite recurring scandals. Like agents in general, no regulatory agent is perfect. But regulators cannot admit imperfection; when regulators ensure trust in the market, it is not functional to expect significant failures. The Madoff scandal demolished that façade rather completely, with Harry Markopolos (2010) detailing how five separate attempts to expose Madoff had been turned away by obtuse, incompetent SEC staff members focused on processing, not investigating, cases.

The more technical the nature of the regulated industry, the greater the external need for the agency's regulatory certification, and the more essential it is that the agency either have the actual ability to determine whether the industry's product claims are true, and/or be able to maintain the credible reputation that it has such an ability. Noting that an agency's image or reputation includes performative, moral, and legal-procedural, as well as technical components, Carpenter (2010) describes the critical role played by the FDA's ascribed reputation for both scientific competence and scientific probity in assuring health product consumers that the scientific status of health-enabling goods claimed to be safe and effective were just that. For example, among the enormous body of evidence he assembles, he gathers numerous quotes labeling the agency as the "gold standard" (pp. 739-740). He also describes the factors that led to a decline in its reputation in recent years (for an extended analysis of competence in regulatory agencies, see Greenwood 1984).

But at the same time that competency myths support trust in the system, they can also shield agencies from challenges and protect deviant industries from effective regulatory control. Indeed, it is in the interest of capturing industries to construct their regulators in the image of perfect agents (cf. Mitnick 1975).

- *Regulatory arbitrage*: Given the constraints of statutes governing agency regulation as well as the administrative process, such characteristic features of agency regulation as regulatory objectives, structures, tools, budgets and other resources must in general be set in advance of implementation of the regulation, i.e., they involve *ex ante commitment*. In addition, the process and political constraints of acquiring additional resources and altering regulatory controls and implementing structures in the public sector typically requires coordination and the assent of many actors. As a result, it is unusual for regulation in place to be matched closely with what is needed to assure compliance. The mismatch of regulatory capabilities and resources with regulating needs provides opportunities for the regulated actors to gain advantaged and protected statuses. Furthermore, whenever effective regulatory implementation requires the coordinated action of several agencies, such *joint action complexity* multiplies the problems of maladaptation in each agency to what is required. On the other hand, actions by a firm undertaking a strategic response to regulation may require only the

firm's own entrepreneurial behavior (although activities such as trade association advocacy may also be present as part of a firm's political strategy) (on strategic use of regulation, see, e.g., Owen & Braeutigam 1978; Mitnick 1981/1993; McCaffrey 1982; Marcus 1984; Wood 1986; Marcus, Kaufman, & Beam 1987; Mitnick 1993; Shaffer 1995; Mahon & McGowan 1996; Yandle 2011).

Thus, in general, government regulation suffers from a built-in structural constraint that can provide niche-like protections for some regulated actors. When regulation is adopted and implemented, government normally commits to a particular regulatory control structure. In essence, the government makes a first-mover decision that assumes that the regulatory designs adopted are to be done once-for-all-cases, with establishment of a semi-permanent control system. In the U.S., that often means a central regulatory agency with implementation via planned delegation in the federal system, planned cooperation with other agencies, and/or a distributed control structure in which area offices house inspectors or other regulatory officials who do the local implementation of the regulation. The constraint of annual budgeting, together with the difficulty of adopting new or modifying old regulations (adoption of a regulation can take a year or more in federal agencies), the constraints of public sector procurement, and the difficulty of modifying staffing within a civil service system, among other factors, severely constrain the ability of regulators to be adaptive. Government can acquire additional resources only via a time-consuming and uncertain process of requesting additional authorizations and appropriations from the legislature, which makes it unable to adapt quickly in crises or simply to make adjustments for effectiveness. In addition, the government must be transparent -- it tells industry what it is going to control and how it will do it, telegraphing its regulating program while permitting industry to largely conceal its strategic actions in compliance. Regulators typically face the classic policing problem of needing to provide plenary and fault-free protection although problems tend to arise and concentrate locally.

I define *positive regulatory arbitrage* as the ability of firms to capture benefits within the uncontrolled space created by the agency problems of maladaptive regulation (see Mitnick 1981/1993 on "strategic uses of regulation"). It is well understood in particular contexts. For example, in the literature on rate-of-return

regulation, the problems of “regulatory lag” (cf. also “regulatory slack”) are well understood and widely-described in the public utility literature: Public utilities ask for rate increases when their costs increase, but if rate adjustments come slowly or are insensitive to the true utility cost structure when those costs decrease, utilities will enjoy excessive returns. The rate-setting process can be lengthy, and, by the very nature of pricing supposedly being linked to the utilities’ rates-of-return on their investment, utilities are incentivized to pad their investment base (e.g., the Averch-Johnson-Wellisz effect). To the extent that commissions are under-resourced, lacking in expertise, or staffed with commissioners lacking interest in aggressive regulation, and feature rate review procedures that allow the utility to benefit from regulatory lag, utilities can effectively shape regulatory outcomes in ways that suggest the appearance of capture.

For another case, consider the dilemma faced by U.S. regulators during the BP oil leak in the Gulf of Mexico in 2010. The prime regulatory body, then called the Minerals Management Service, was widely described as captured by the oil industry (Gold 2010). Environmental regulatory bodies and regional political entities lacked the expertise to direct a solution to the leak. In the end, the Federal government relied on the polluter to design and implement solutions, while retaining a nominal say over the exercise of each option. BP reported discharges of oil far lower than later analysis indicated was the case, and an inept government was slow to intervene to correct the reports. Critics charged that BP deliberately low-balled the discharges because Federal fines were tied to the scale of the leak (Power & Tracy 2010). In essence, BP engaged in regulatory arbitrage, both before and during the leak.

Regulatory arbitrage can also produce negative impacts on regulated actors, e.g., when government controls are slow to adapt to competitive or technological changes so that regulated actors have an inability to avoid needless costs in implementing controls that do not deal with current problems. But *negative regulatory arbitrage* is likely to be far less common than its positive counterpart, as more nimble firms adapt away from the negative impacts. Firms have better information about regulatory impacts and the changes in their production processes that can minimize negative outcomes. And they have the ability to make decisions without the delays of political system processes, schedules, and electoral framing effects.

• *Relational political governance featuring overhead agency controls and channel management*: The modern literature on delegation as agency and the modeling of regulatory relationships as agent-principal relationships began with Mitnick (1980, pp. 326-337 and *infra*; 1975), and there is now a very large and growing literature on political control of the bureaucracy. That literature expanded from a focus on how Congress, via tools such as appointments, presumably dominated bureaucratic behavior (Weingast 1981, 1984; Weingast & Moran 1983), to a range of means for shaping a regulatory body's behavior, including budgetary controls, subtle influences identifiable by mapping the policy positions of interested legislators, specification of structural characteristics of administrative instruments, procedural controls, effects on the costs of particular kinds of decision making, Presidential influence, and even actions that affect the reputations of regulators, among other tools of influence (examples of this work, some critical of it, e.g., noting external factors such as degree of media coverage, signals from wealthy groups rather than overhead ones, and the existence of multiple principals, include Aranson, Gellhorn, & Robinson 1982; Moe 1982, 1985, 1987; Wood 1988; McCubbins, Noll, & Weingast 1987, 1989; Spiller 1990; Wood & Waterman 1991; Macey 1992; Bawn 1995; Hammond & Knott 1996; Carpenter 1996; Carpenter 2002; Spence 1997, 1999; Waterman & Meier 1998; Balla 1998; Furlong 1998; Scholz & Wood 1998; Waterman, Rouse, & Wright 1998; Waterman & Rouse 1999; Reenock & Poggione 2004; Epstein & O'Halloran 1999; for discussion of the instruments that manage delegation both in the oversight body and within agencies, see Balla 2011). For some factors, e.g., budget, this literature does in fact find evidence of political influence on the agencies, but in some cases the agency can retain discretion (for examples, see Balla 1998; Spence 1999; cf. Carpenter 2001; there are quite a large number of caveats in the literature about the sources of influences and their effects).

The political control literature emphasizes "overhead" controls -- whether from legislators or superior executives, such as the President, or traced back to the constituency interests to which reelection-seeking legislators respond. If the relationship is to be capture, however, it must go beyond political influence to form a stable relationship with industry that consistently shapes decisions and/or

performances by the agency so as to intendedly benefit that industry. That is why these “overhead” controls may be viewed as relational, so that what is established looks like stable channels of control that protect those constituencies.

The distinguishing character of this mechanism is that it operates via political intermediaries with legal authority over the agency, an authority that is legitimated by the rules of the political system. Legislators are elected agent-representatives. Hence any capture that occurs is done nominally in the people’s name. The logic of the iron triangle is based in incentives that guide or distort behaviors. In relational political governance, however, capture is anchored in the basic legitimacy of the overhead controls. Thus, in the Congressional dominance approach, the industry dominates the oversight committee, which acts with full legitimacy, and controls the agency via many of the same tools said to be operative in iron triangles, such as budget appropriations (see, e.g., Weingast 1981, 1984; Weingast & Moran 1983).

Carpenter’s careful work on bureaucratic autonomy (2001) provides a nuanced counterpart to the political control stream of work. He demonstrates that some agencies are able to politically differentiate themselves from political forces that might otherwise control them, are able to produce entrepreneurial bureaucratic outputs that reflect “unique organizational capacities” (p. 14), and are able to generate robust “political legitimacy” -- taken as equivalent to “reputation.” Together, these conditions set the agency apart and allow it to achieve autonomy in its work (for a related perspective, on administrative autonomy, see Croley 2008). Such agencies are captured only by their able management, of course. But Carpenter’s observations do not challenge the notion that capture or something like it can occur -- relatively few agencies demonstrate the competencies that Carpenter describes. Indeed, he discusses how the US Interstate Commerce Commission completely failed in these areas.

- *Subgovernmental institutionalization*: Subgovernments feature a closed system of policy making in which certain actors -- e.g., some interest groups, some institutional actors, and not others, are recognized as legitimate players. Relatively stable expectations develop regarding demands, agenda-building processes, specific role incumbents, negotiating practices, alliances, cultural and normative commonalities,

and so on. Although the system may be sustained at least partly by the incentive effects described under incentive-shaped individual decision making, i.e., the effects said to produce iron triangles, subgovernmental networks are virtual institutions that exist across formal governmental agency and process lines.

Subgovernments have been variously described (though not necessarily with the same intended referents) in terms of “issue networks,” “policy subgovernments,” “advocacy coalitions,” and “institutional constellations” (e.g., Heclo 1978, Gormley 1986, Hamm 1983, 1986; Sabatier 1988; Jordana & Sancho 2004; cf. “stakeholder partnerships,” Leach, Pelkey, & Sabatier, 2002; for other systems models of regulation, see, e.g., Krasnow, Longley, & Terry 1982; Meier 1985; Mitnick 1991/1985). Subgovernments can display capture-like stable policy domination by a particular set of actors, critical supportive behaviors by a single major constituency (e.g., Sabatier 1975), or a serial competition in which, as issue and subgovernment membership remains stable, actors compete to dominate policy outcomes. Where contests in the given issue area cycle over time, they can reappear with the same set of participants competing to shape the policy outcome in the current apparition.

Policy governance is virtual, not bounded by formal institutional lines. For example, contests in the U.S. over the original Clean Air Act and Clean Air Act Amendments have reappeared every few years, often with the same industry, association, interest group, and legislative actors carrying the debate. Obviously, capture only occurs in those cases in which a subgovernment with a particular membership and pattern of operation is stable, so that decisions and/or performances by agencies within the subgovernment are determined consistently with respect to a narrow range of interests dominant in the subgovernment. In such cases, subgovernments can look very much like iron triangles, except that the number and stability of the actors, complexity of the system, and basis for the subgovernment’s persistence may be more institutionally elaborated and go beyond simple incentive relationships.

- *“Arational” regulatory process and instrument/tool design:* In the overwhelming number of cases, new regulation uses the institutional forms and particular tools or

instruments of control that other agencies have used in the past. Institutional theory recognizes that such mimetic or “isomorphic” behavior is pervasive (DiMaggio & Powell 1983). After the U.S. Interstate Commerce Commission was made an independent regulatory body, outside executive departments in 1889, in response to fears that an incoming President and newly-elected Congress would water down the implementation of the 1887 Act, subsequent regulatory bodies were also created as independent commissions. The rationale for that design -- originally political -- was, in essence, created post hoc. The independence of the commission was supposed to be sustained by expert commissioners acting in impartial ways outside immediate political controls. As Huntington (1952) argued, however, the ICC and the transportation industry it regulated developed a mutually supportive relationship, in effect protected by the agency’s independence.

The use of standardized designs for regulatory instruments, and for the design of the administrative process itself, can benefit industries better able to work with those designs. Regulatory rulemaking in its fully-explicated form is costly and time-consuming, requiring multiple stages of depositions, briefs, hearings, public notice periods, and so on (on the advantages and limitations of “deep pockets,” cf. McCaffrey 1982). The literature on strategic use of regulation (e.g., Mitnick 1981/1993) argues that the ability to participate extensively in rulemaking and other formalized components of the administrative process gives significant advantages to larger firms (but cf. Carpenter 2004; McCaffrey 1982). Such firms can support the response bureaucracy necessary to negotiate this process, including influencing the design and choice of regulatory tools as well as the level and stringency of enforcement of any standards. Thus, active participation in key parts of the regulatory process can provide significant comparative advantages and benefits to certain regulated parties over others affected by the regulation. It follows that larger firms are more likely to be able to dominate and/or capture the regulatory decision making and performances than their smaller competitors.

- *Implementation slippage featuring corruption, expedience, and/or identification processes:* During implementation, capture can occur as regulatory performances

become dominated by line regulators who become very responsive to, and/or identify with, the industry with which they work closely.

Capture is facilitated when the same regulators work with only a few firms in one industry, are in direct and repeated contact with the regulated parties (usually the same contact people in the industry), work with the industry at a physical distance from administrative supervision, have come out of or been trained within that industry, lack true professional training and/or professional relationships that can provide prestige or status rewards as well as normative guidance from the profession, lack sources of information on the industry from sources other than the industry itself, see few opportunities for career mobility out of their existing regulatory role relationship (including to higher paying and/or higher prestige regulatory positions), and have relatively low compensation (Ayres & Braithwaite 1992; Mitnick 1982; on regulator-industry relationships, cf. Reed 2009).

There are at least three patterns:

First, regulators can be directly corrupted or bribed. There have been, for example, recurrent scandals in the meatpacking industry in which inspectors stationed at meatpackers were bribed.

Second, under-resourced regulators faced with complex tasks and deadlines, and constrained to retain good working relationships with personnel in the industry with whom they must interact constantly, economize and simplify regulatory tasks in cooperation with the regulated industry. The consequent reduction in regulatory stringency may be seen as expediency that often serves the industry's interests. For example, Ayres and Braithwaite (1992) describe conditions of this type in the nursing home industry.

Third, regulators trained within an industry and lacking competing information sources work in close contact with industry people concerned with the same issues. Over time, their attitudes and behaviors become indistinguishable from those in the industry; they identify with and defend the industry's interests.

Aspects of these patterns can be found in the industry-agency leg of the iron triangle model. A proffered solution is similar -- inject countervailing interests, such

as a public interest group (see the “Tripartism” model of Ayres & Braithwaite 1991, 1992; for an incentive systems model that does this, see Mitnick 1991/1985; see Sabatier 1975 on the effects of interest group activism).

- *Path dependence opportunism*: A robust, largely empirical literature in comparative economic systems has developed that investigates the macro conditions of, distribution of, and societal extent to which the tangible benefits of public action have been systematically steered to advantage private parties in certain countries. This literature, often labelled, “state capture,” has developed largely apart from the much older literature on capture in political science that first observed and theorized about similar phenomena; indeed, there are virtually no citations to the relevant political science literature or even to some of the key works in the strategy literature. State capture has, however, been an important focus of literature that examined the transitioning of communist, centralized economies to more market-driven economies.

Although the implications of this literature are logically covered below under constitutional bias (government provides special protections for certain private parties, advantages that are not enjoyed by other private actors), the advantages have often become available precisely because the economy has been in transition from central to nominal market controls. Thus, capture was made possible because of the possibility of opportunistic actions in situations in which both property rights and the nature and source of central controls or regulation was changing. It is at that point that what Kaufmann (2005) defines as “corruption” occurs: “the privatization of public policy.” The process of locking in private benefits is facilitated by what is in effect imbalanced affective access politics, as some parties receive differential access and differential benefits -- “crony bias” (Hellman and Kaufmann 2002). Unlike imbalanced affective access politics, the privatization of public policy is accompanied by the provision of tangible private, personal benefits to government decision makers, e.g., bribes; such payments go well beyond reelection assistance such as campaign contributions. Hellman and Shankerman (2000) note that in order for state capture to be effective, private benefits must be made available and the number of firms receiving them must be limited. Because public policy actions protect private

industry, acting at variance to what good governance would require, Kaufman (2004) labels such behavior “legal corruption” (also see Kaufman & Vicente 2005).

State capture typically occurs in the early stages of transition, and those actors that benefited from the protection obtained during the early transition oppose reforms strongly (Hellman 1998). A “culture of informality” reflected in extensive informal networks replaces strict reliance on the rule of law and can support the easy flow of private benefits (Grødeland 2007). Young (2010) notes, however, that transition from domination by the oligarchs who captured state benefits during the market transition period is possible, and can be facilitated by crisis in the economic system, change in the political system, and the influence of external actors.

Certainly, a significant feature of the state capture approach is its reliance on path dependence -- the opportunism occurs, but where or how it is manifested depends on how the system is changing, and who controls the supply of private benefits. The setting for state capture bears some similarity to McCaffrey’s (1983) stochastic process approach that sought to describe how regulation fails in systems in which central control and consistent action is replaced, in practice, by uncoordinated, incomplete and incompletely informed actions, actions driven by parochial interests that conflict with other interests and with inappropriately drawn regulations.

- *Constitutional system biases*: Systematic biases, producing stable protections, i.e., capture, can result when the formal system rules -- the constitutional rules, whether established by a formal constitution or via legislative action -- have the effect of conferring comparative benefits on some over other actors. In effect, using the common metaphor of a playing field, the rules in place cause the field of competition to be tilted in a way that gives an advantage to one side and/or disadvantages the other. This effect is the counterpart to imbalanced affective access politics, in which one or more groups have enhanced power, yet all groups seek access via the same level constitutional field.

Of course, the rules can permit some interests with deeper pockets to gain an advantage as well as to be relatively stronger players on the field -- that is, both effects can operate at the same time. The U.S. Supreme Court’s decision in *Citizens*

United v. FEC (2010) extended free speech rights to corporations, reasoning that they were persons who had the same First Amendment rights as other persons. Corporate contributions were deemed a form of free speech. Via their ability to support extensive lobbying, corporations were already able to seek disproportionate power under imbalanced affective access politics. Thus the *Citizens United* decision created opportunities for deep-pocketed firms seeking to influence government both to flood the electoral process with funds working on behalf of their favored candidates and to enjoy favored access to governmental decision makers.

When constitutional bias is conferred directly, governmental action has structured the rules to intentionally advantage some parties over others. Examples include cases in which governance systems guarantee representation by certain parties, as when union representation on corporate boards is legislatively mandated, as is the situation in many EU countries (for a discussion of issues re worker representation on boards of directors, see, e.g., Hammer, Currall, & Stern 1991), or in which electoral systems mandate representation that in effect provides regulated constituency interests with a central role in legislating.

Baron (1997) describes Fujifilm's dominance over Kodak in the Japanese market as resulting from a combination of control over market mechanisms, such as the distribution network for film, and protective treatment of Fujifilm in regulatory contexts -- to use the metaphor, the playing field was tilted against Kodak in Japan. When the market is structured by government actions so that some actors retain benefits that exceed the actors' opportunities elsewhere, there exists what Baron (1995a, 1995b, 1999) calls a "rent chain." Baron (1997) cites former Kodak CEO George Fisher labeling Fujifilm's advantages in Japan as a "profit sanctuary." Baron (e.g., 1999) notes that defense of capture benefits is done via "mobilization of the rent chain." Bonardi, Hillman, and Keim (2005) describe factors that make political markets more attractive to firms.

The stream of research on state capture makes repeated, sometimes explicit references to the capture of the "rules of the game" (see, e.g., Kaufmann 2004, p. 83) or to opposition to evening the "playing field" (Young 2010, p. 3) by the elites that gain private benefits during the transition to a market economy. Hellman, Jones, and Kaufmann (2000, p.3) distinguish "captor firms" from merely "influential firms,"

where captor firms “make private payments to public officials to affect the rules of the game.” Hellman and Kaufmann (2001, p. 2 of ms.) note that “state capture refers to corrupt efforts to influence how those laws, rules, and regulations are *formed*. Bribes ... are the classic examples of grand corruption through which firms can encode advantages for themselves into the basic legal and regulatory structure of the economy.” Thus, a characteristic feature of “state capture” is creation of what I have termed constitutional bias.

Constructing a normative *theory of fiducial regulation*

The analysis of capture mechanisms suggests the utility of what I will term a normative *theory of fiducial regulation*. How can we design regulatory systems, based in a theory regarding the production of adverse behaviors, so as to avoid capture? Any or all of the mechanisms proposed above may be operating to produce capture, so the design solution may not be a simple one. Rules that put restrictions on the revolving door, for example, do nothing to interfere with capture based on exploitation of regulatory arbitrage. And public policy changes that inhibit one mechanism may encourage industry to seek protection via other mechanisms.

The mechanisms described below reflect a wide variety of social science theories. The assumptions and logics of those theories are not necessarily commensurate. For example, mimetic institutional responses are not necessarily the result of self-interested, incentive-driven behavior. Thus, the use of the set of mechanisms, drawn from such a diverse theory base, to develop a single normative theory that instructs how capture may be avoided is perilous. Indeed, the simultaneous use of potentially conflicting social science theories in an expedient effort to elicit the apparently best-fitting explanations may be called *theory-shopping*. Thus, the effort below must clearly be labeled as speculative -- a more careful restatement that disentangled the complex set of assumptions and logics implicit in the discussion might generate a theory with a somewhat different appearance.

Furthermore, it is always difficult to make claims about something that was avoided or did not happen. Although the mechanisms conducing to capture are in many cases well-described in the literature, the existence of multiple paths makes it difficult to rate the criticality or universality of any particular path in producing capture. The huge size of the literature discussing capture suggests its importance, but we lack good empirical studies that attempt to carefully disentangle these multiple paths. Indeed, although I have offered a careful definition of capture, operationalization of capture and the identification of cases of capture with enough specificity to permit their systematic comparative study remain fugitive achievements. Finally, the analysis is guided mostly by the U.S. experience, and U.S. institutions, and must be adapted for other contexts.

In general, the theoretical discussions above suggest that the following design principles could interfere with the production of capture. The propositions listed do not exhaust the implications of the previous analysis, though they do suggest the range of interventions that are possible.

Table 1: Some Principles of a Normative Theory of Fiducial Regulation

- **Access Balancing**
- **Buffering**
- **Deliberative Substitutional Rigidities**
- **Professionalization**
- **Competitive Knowledge Sourcing**

- **Incentive Competition**
- **Information Auditing**
- **Development of Adaptive Control Portfolios**
- **Entrepreneurial Autonomy**
- **Open Subgovernance**
- **Regulatory Tool Adaptation and Innovation**
- **Codetermination**
- **Transition Transparency**
- **Field Balancing**

A Theory of Fiducial Regulation

- Prop.: *Access Balancing*: Regulatory designs that explicitly balance the capabilities of groups to access the political system are less likely to produce capture.

Corollary: The use of proxy advocates reduces capture.

The principle of *Access Balancing* follows from the discussion of imbalanced affective access politics. The new US Consumer Financial Protection Bureau established under the Wall Street Reform and Consumer Protection Act of 2009 (signed 2010; the “Dodd-Frank Act”) is in fact designed to serve as a proxy advocate to re-balance the ability of consumers to access regulators and protect their interests.

- Prop.: *Buffering*: Regulatory designs that promote stability in staffing and adequacy in resource support, and reward regulatory capital, are less likely to produce capture.

The need for buffering stems from the instabilities and manipulations of substitutional governance, and the distortions of incentive systems that skew individual behaviors. Regulators will always find it difficult to sustain consistent, effective controls under their mandates when their jobs become transient, they lack necessary resources, and they find that the knowledge and capabilities that they develop in regulating as a result of their experience, their “regulatory capital,” is more valuable outside than inside their agency. The maintenance of neutral governance requires buffering from such effects. Development of regulatory “careers” that recognize, reward, and take

advantage of regulatory capital must mean more than enjoyment of the benefits and protections of the civil service.

- Prop.: *Deliberative Substitutional Rigidities*: Regulatory designs that make it difficult to change personnel or procedures or decision criteria in response to political influences are less likely to produce capture.

The old view of regulatory independence represented in the rationale for the independent regulatory commission has been criticized because it protected mediocrity in administration, isolated regulatory decision makers from policy initiatives, and, rather than independence, tended to promote long-term, stable, supportive relationships with the regulated industry, i.e., capture. But we can't have it both ways -- it cannot be argued that exposure of agencies to administrative manipulations makes them open to undesirable political controls, but that shielding them exposes them to threat of capture. Independence, by itself, is probably not a bad thing to encourage, especially if it is joined to expectations of modernization in practice, i.e., via professionalization (see below). What needs to be avoided are biased governance changes that are driven by private parties that will benefit under the changes. For example, multi-year budgeting supporting professional staffing levels necessary to implement informed, effective regulatory controls creates positive rigidities that inhibit biased governance substitutions. The basic principle is actually *pre-commitment* -- creating a rigid framework guaranteeing things like necessary resources, open procedures, and transparency reporting, that, once adopted, is costly to alter.

- Prop.: *Professionalization*: Regulatory designs that reinforce deep professional knowledge bases, professional networks, and professional norms, are less likely to produce capture.

External incentive systems that reward individuals who have developed deep reserves of regulatory capital, without regard for the societal impacts of re-directing such capital to private over public uses, especially when that capital is built up in the public

service, can be countered only with competitive incentive networks. When regulatory managers find that their most important career rewards come from professional practice, and that their professions support and/or sanction approved practice and provide normative guidance for such practice that comes from outside the political network, they are far more likely to provide neutral governance. Professionalization is not a cure-all and has its own issues (see, e.g., McCaffrey 1982, 1983), but in our context it is a competing source for correction and support .

The second rationale for supporting regulatory professionalization is rooted in providing substantive support for competency myths. Because regulatory systems depend on such myths, the solution is simply to provide a real basis for the myths.

- Prop.: *Competitive Knowledge Sourcing:* Regulatory designs that admit and support alternative sources of technical knowledge critical to regulatory decision making, rather than relying on sole, usually industry-mediated sources, are less likely to produce capture.

It is well-accepted that whoever controls the shaping and flow of information in regulation, controls regulatory outcomes. U.S. regulation is highly dependent on information from the regulated industry. Moreover, the U.S. administrative process, although nominally adversarial, depends on accumulation of information supporting decisions, as required by statute and agency rules, but does not require reviews of agency decisions to actually examine and critically evaluate the support for the original decisions. That is a recipe for formalism in regulatory responses, especially when the adversaries lack equivalent support during the process.

- Prop.: *Incentive Competition:* Regulatory designs that provide incentives that compete with those mediated by the regulated industry, or that block the promulgation of industry incentives, are less likely to produce capture.

In essence, regulatory designs must either balance or block the existing incentive flows. For example, campaign contributions by the regulated industry may be subject

to disclosure requirements; regulators should be excluded from attending industry celebratory events.

- Prop.: *Information Auditing:* Regulatory designs that are reliably science-based, i.e., truth-testing, rather than predictably adaptive to political complaint channels, are less likely to produce capture.

Thus, the U.S. administrative process is structured to defer to agency determinations without regard to external evaluation of the scientific status of those determinations; the agency is presumed expert. So as long as it followed the rules and compiled substantial evidence per the statute's prescriptions, it is presumed that the agency exercised expert judgment on that record. In fact, practice shows that so-called "scope of review" is often gamed by competing interests, while an inexperienced and passive agency stands by merely hosting an expanding record. Hence, what passes for science can be treated, administratively, as substantial evidence on the record, and used to support industry benefits.

- Prop.: *Development of Adaptive Control Portfolios:* Regulatory designs that permit rapid adaptive responses, together with pre-committed coalitional implementation, are less likely to produce capture.

Regulatory arbitrage is possible largely because of maladaptive regulation, both within an agency and within and across levels of government. Regulators are caught regulating the wrong things, at the wrong levels of stringency, using the wrong control instruments, with insufficient staff and resource support, without needed allies from elsewhere in government, and without the necessary cooperative arrangements to effectively implement a distributed control system. Such problems suggest that regulators require pre-commitment of tools, resources, and cooperative implementations. Regulation must be designed as adaptive -- it must expect change, rather than suffer from the presumption that a once-for-all solution has been developed by the legislature together with permanent regulations to resolve agency

discretion. Permanent regulation is regulation designed to be exploited, and designed to fail.

- Prop.: *Entrepreneurial Autonomy*: Regulatory designs that permit peak regulatory officials to act in entrepreneurial ways to achieve the purposes of the regulation, and, critically, to build support for the regulation, including its perceived legitimacy, are less likely to produce capture.

The problem with overhead controls is that regulators are constructed as puppet-like agents dependent on executive and legislative mediation of factors critical not only to their success, but to their everyday performance. Perhaps it may be more proper to view the agency as a hostage than as subject to Congressional dominance or other forms of political controls. Thus, funding regulation via user fees rather than via centralized budget allocation; allowing regulators to make cooperative service and regulatory implementation agreements; expecting regulatory officials to act as the true public face of the public purposes embodied in their agency's delegation; expecting adaptive behavior by the agency to produce practical and effective regulation that reaches its purposes rather than just follows its rules; are all aspects of the sort of bureaucratic autonomy that Carpenter (2001) found successful.

- Prop.: *Open Subgovernance*: Regulatory designs that open subgovernmental discussions to new actors, and establish routine mechanisms for making those discussions transparent, are less likely to produce capture.

Subgovernments, even those in which challenging actors such as citizen groups have been added to the iron triangle, tend to develop as stable forums that exclude new members and new ideas, and merely cycle through contests in which one or the other of the participant groups is more influential than the others. In the worst cases, even with conflict, one group -- usually the industry -- dominates, and the subgovernment becomes little different in outcome than an iron triangle. Establishment of organizational proxy advocates, such as the Consumer Financial Protection Bureau, rather than just advocates interior to an agency or limited in advocacy scope, together

with both resource, process, and transparency supports, can help make subgovernments more open and assure that outcomes will be deliberative and not preordained.

- Prop.: *Regulatory Tool Adaptation and Innovation*: Regulatory designs that promote the continuous development of new regulatory tools and the adaptation of old ones to new circumstances are less likely to produce capture.

Innovation in regulation compels innovation in the regulated industry. Continuous improvement makes it difficult for industry to dominate. On the other hand, continuous regulatory innovation may make it easier for large firms to follow the regulator than smaller firms with fewer resources to devote to regulatory adaptation. Thus, regulatory innovation must also provide supports for small firm compliance, or risk producing the counter-result of increased industry concentration, potentially with even greater impacts on the regulatory process.

- Prop.: *Codetermination*: Regulatory designs that institutionalize the participation of naturally conflicting interests, both at the policy-determining and at the implementation levels, are less likely to produce capture.

Recall that capture can result at either the decision or the performance stages. Corruption, expedient behavior by regulators, and/or identification of regulators with representatives of the industry can cause the regulation to be captured just as surely as if the regulatory policy had been designed by industry to benefit it. One way to deal with capture from these sources is to provide a hostile monitor to observe the process. If activists for food safety were to participate in meatpacking inspection, it is far less likely that unsafe meat would be passed as a result of an improper relationship between meatpacker and inspector. Formal representation of such potentially conflicting interests can thus be one solution. “Codetermination,” i.e., worker representation on European boards of directors, has a similar rationale, in part. ”Co-production,” in which public provision of a service is done in cooperation with citizen or nonprofit provision (for example, a neighborhood watch) has been implemented

successfully in many contexts. What is different here is that the parties co-producing the outcome -- regulatory compliance, which can include regulators, the regulated industry, and affected citizens, may have conflicting interests.

- Prop.: *Transition Transparency*: Regulatory designs that formalize the transparency of major organizational and economic system transitions are less likely to produce capture.

When economic system transitions occur, normal rule-of-law safeguards lack effective overseers; it is often unclear who has the legal power to make important allocations of state benefits. The same argument is valid at more micro levels, e.g., when services shift from one agency to another, or new forms of control are being implemented and the detailed processes and managers of oversight are not fully established. Such circumstances are ripe for opportunism. Because one cannot refer the control to an authority that may not yet exist, the best alternative may be to use the light-of-day: Provide full transparency about what benefits are going where, with what oversight. If the political system retains democratic oversight, any transparent reporting that documents the “grabbing hand” may generate countervailing pushback.

- Prop.: *Field Balancing*: Regulatory designs that explicitly provide equivalent advantages under the law, i.e., that treat every participant the same as every other -- that are aimed at leveling the playing field -- are less likely to produce capture.

This is the field counterpart to access balancing. The actors must have the same capabilities to do access, and the political playing field must provide the same opportunities for access, to every party.

The principles listed in Table 1 are speculative guides to designs that may inhibit regulatory capture. As already noted, the theories underlying them are not necessarily commensurate with one another; one cannot claim that we have boiled it all down to

the core levers that would certainly save us from the distress of captured regulatory systems. But it is an attempt to get the process started.

Conclusion

The concept of capture has been defined as referring to cases in which a regulated industry is able to control decisions and/or performances by regulators related to the industry. It requires three conditions: essentiality and/or generality of the benefit, stability or persistence of provision of the benefit, and the public provision of defensive measures or actions that entrench the benefits against actual or potential challenges. Based on the literature of capture, twelve mechanisms claimed to facilitate capture were identified. Those mechanisms, together with the logics that constructed them, suggested a number of principles for the design of regulatory systems that might avoid capture. These principles were offered as the core of a speculative normative theory of fiducial regulation. The paper identified several new concepts in understanding regulatory behavior.

Regulatory reform has seldom developed systematics to guide its interventions. Usually, attempts are based on certain leading complaints of the moment, and certain favored solution approaches receiving wide attention at the time. There is little in the way of trying to systematically understand what goes wrong in regulation, and then -- a critical step -- using the descriptive theory that generated such understanding to build careful normative theory to repair the mess. In other words, we need to go, with care and system, from understanding the undesirable behaviors of regulation, to those solutions that the theory says would avoid what has been undesirable in the past. That's a normative theory -- what you should do to get certain desired ends. The two parts of the process are essential -- both descriptive theory, based in abstractions of the way the world works, and normative theory, employing the now discovered descriptive logics to inform us of designs that would avoid what is undesirable.

Indeed, this paper may be seen as an exercise in developing a small piece of a general theory of social repair. Although the goal of our social science may be understanding, there is no reason to stop there.

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