

**Bootleggers and Baptists in the
Theory of Regulation**

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Abstract: Theories of regulation offer thought facilitating devices that may help to explain the functioning of government in a political economy. Among formal theories put forward in the 20th century are public interest, capture, special interest, and money for nothing. The Bootlegger and Baptist theory is based on the frequent observation of two distinct and different interest groups pursuing the same regulatory end. The name comes from experiences observed in regions of the US where religious groups oppose the Sunday sale of alcoholic beverages, a position welcomed by bootleggers, illicit sellers who welcome a wider market for their services. In the context of regulation generally, the “Baptists” are those who take moral high ground in the efforts to gain regulation, as with environmental groups. The “bootleggers” are those who gain monopoly rents when the Baptists successfully provide an output restriction, as when producers of clean energy see coal operations closed down. Part of the rapid rise of US regulation since 1970 may be better understood by applying Bootlegger/Baptist theory to the political economy that produces regulation.

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Bootleggers and Baptists in the Theory of Regulation

The Bootlegger and Baptist theory of regulation (B&B) was born in 1983 when I was Executive Director of the U.S. Federal Trade Commission (FTC) (Yandle, 1983). Along with other duties, I was responsible for the agency's Consumer Advocacy Program, an activity where the FTC intervened in the regulatory proceedings of other federal agencies in an effort to maintain and enhance the competitiveness of the U.S. economy. The agency's intervention activities revealed a number of instances where seemingly odd interest-group alliances supported the same regulation. This was not the first time I had observed the odd-alliance phenomenon.

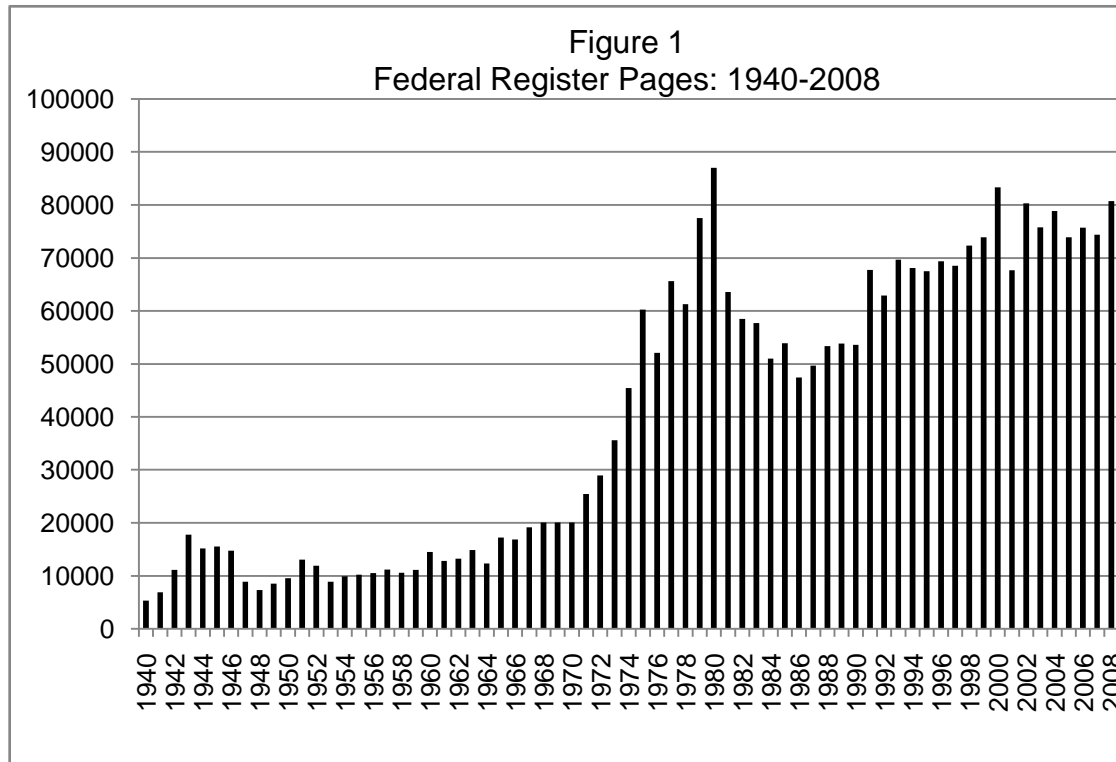
The idea that demand for the same regulation could come from two distinctly different interest groups, one that seemed to take moral high ground and another that simply wanted economic rents, had come to me in 1977 when I was a senior economist on the staff of the President's Council on Wage and Price Stability. I was responsible for reviewing and commenting on new regulation proposed by the U.S. Environmental Protection Agency (EPA), the Federal Trade Commission, and the National Highway Traffic Safety Administration. In reviewing those rules, it became obvious that industry opposition to regulation was far from being monolithic. Almost invariably, there were firms or industry sectors that gained from regulation. For example, in EPA's proposed rules regulating copper smelter emissions, the agency indicated there would never be another U.S. copper smelter once the rules became final. The rules, which set more stringent standards on new smelters than existing ones, were supported by major environmental groups. Later work on the copper smelter episode by Maloney and McCormick (1982) showed that copper producer shareholders earned abnormal positive returns when the smelter rule became final. The major environmental groups celebrated, too. The results suggested that both polluters and environmentalists could gain from properly crafted regulation.² In my work on the first U.S. auto fuel economy rules, which were supported by environmental groups, I found that General Motors was lobbying for stricter standards

while other major auto companies warned of the dire consequences associated with the pending rules. (It turned out that General Motors had led the industry in downsizing its fleet of cars.) I found similar odd-alliances in my review of the development of the nation's first water pollution control statutes.

The B&B theory gets its name, of course, from a common phenomenon in the United States in regions that restrict the sale of alcoholic beverages on Sunday. Baptists lobby for the associated regulations; they prefer a world where less alcohol is consumed. Bootleggers, the illegal sellers of alcoholic beverages, support the laws as well. Sunday closing laws shut down legitimate sellers, giving an open field in which bootleggers can sell their wares.

U.S. Clean Air and Clean Water statutes had a common characteristic that made them ripe for Bootlegger/Baptist cartelization activities. There were stricter standards for new sources than for existing sources. Apparently, the existing U.S. copper smelters saw the new rules as a way to cartelize their industry. With rising demand, price would go up; and with restricted entry based on meeting stringent standards, profits for industry members would increase. EPA and the environmental groups would happily be the cartel enforcement agents.

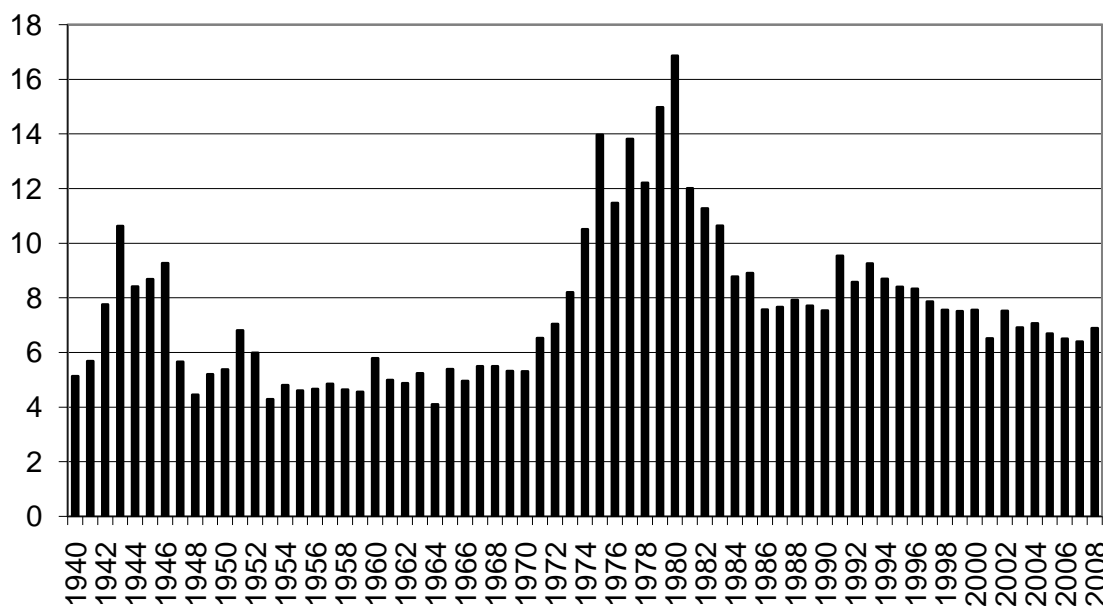
My B&B theory was a small part of a growing literature on regulation theory. Efforts by economists and other social scientists to explain the frequency and features of government regulation had moved in lock-step with the rise of regulation in the United States during the 1970s and 1980s. Those two decades saw a dramatic increase in both the number of federal regulatory agencies and the pace at which the new agencies produced regulation. One measure of this activity is seen in Figure 1, which reports the annual count of new pages in the *Federal Register*, a daily government publication in which new and revised are published.



Source: Crews (2010) and author calculations

As shown there, regulation contagion as measured by *Federal Register* page count, emerged around 1970 and peaked in 1981. Of course, one may argue that new and revised regulations are necessary inputs for producing GDP, in which case there would be more pages with more production. Figure 2 shows the number of pages per billion dollars of real GDP. Here, we see a mountain of regulation pages was formed in the 1970s and 1980s.

Figure 2
Federal Register Pages per \$Billion Real GDP
1940-2008



Source: Crews (2010) and author calculations

It was during the 1970s that major new social regulatory agencies were formed. These include the U.S. Environmental Protection Agency, the Consumer Products Safety Commission, the Occupational Safety and Health Administration, and the National Highway Safety Administration. They joined older economic regulatory agencies, such as the Securities and Exchange Commission, the Interstate Commerce Commission, and the Federal Communications Commission. The new agencies were required by statutes to provide regulatory protection for the environment, for workers in the factories, mines, and other workplaces, to improve conditions that affected occupational health, and to make autos and consumer products safer. As opposed to regulating prices, entry, and fitness, the new agencies specified how things would be produced and marketed. The United States, which previously had been primarily regulated by diverse state common law, city ordinances, state statutes and regional compacts became a code law country for a large category of economic activities.

But while social regulation was experiencing explosive growth, old time economic regulation was in a sharp state of decline. Mancur Olson (1984, p. 249) called attention to this and noted that:

One striking example has, wondrously, attracted very little journalistic attention. The Carter Administration and its immediate predecessors made great strides in deregulating many industries, such as trucking, airlines, railroads, securities markets, and banking. This deregulation greatly increased the scope of free markets. It would take us far afield to go into the unfolding empirical evidence about the consequences of this deregulation here, but the preliminary indications are that it has greatly increased the efficiency of the American economy. Most strikingly in the area of trucking, the Reagan administration (at least up the point when this essay is written) has practically stopped this deregulation.

Pages of rules were being printed for the new social regulatory agencies, such as EPA, but pages of old rules were being removed for the older economic regulators, such as the Interstate Commerce Commission.

My explanation of the timing of the rise of social regulation and decline of economic regulation turns on the emergence of national network TV; this provided for the first time, a low-cost way for producers of consumer goods and services to market at low cost to a national market (Yandle, 2010a). The rapid rise of national markets for consumer goods at the margin made state and local regulation obsolete. Firms operating in the new national market lobbied for federal laws and regulations. They also lobbied for the elimination of regulations that affected their ability to communicate and ship within the national market. Explaining why there were so many new rules in the decade of the 1970s and 1980s, does not explain the lobbying effort for certain common features found in the new regulations that emerged.

Why was command-and-control, technology-based regulation the dominant form of regulation preferred by the new social regulators? Why not economic incentives, taxes, and market processes? Why did most social regulation require less stringent rules of existing firms than for new ones? Why were environmental regulations generally more rigorous for newly developing regions than for older

regions? Other theories of regulation cannot answer these questions. But B&B theory helps to answer these questions. So where does B&B fit in the panoply of regulation theories?

Theories of regulation

Five theories offer potential explanatory frameworks to use when considering features of regulation: Public Interest, Capture, Special Interest, Money for Nothing, and Bootleggers and Baptists. The public interest theory is the first and oldest theory of regulation and is not associated with one particular scholar. This theory holds that politicians and their appointees systematically seek to serve a broad public interest, always searching for lower cost ways to provide public benefits rather than advance the interests of particular groups at the expense of the public generally. If carbon emissions, other pollution, unhealthy working conditions, or teenage smoking are the problem to be addressed, then the legislature seeks to minimize global costs in reducing the cost that pollution, hazardous working conditions, or smoking impose on the population at large. If the cost of regulating is larger than the cost imposed by harmful activities, no action is taken. Of course, the public interest theory recognizes that politicians are human, and as a result, errors and even deliberate acts of chicanery will occur, but these failings are the exception, not the rule.

Dissatisfaction with the ability of the public interest theory to predict outcomes led to the development and refinement of the capture theory, a notion associated initially with the work of political scientist Marver Bernstein (1955) and economic historian Gabriel Kolko (1963) but later formalized by Stigler (1971). Capture theory recognizes that politicians and regulators face agency costs and the knowledge problem: There is no clear-cut definition of what might be the public interest for each bill being considered in a legislative session or for each rule a regulator must devise. To help remedy the situation, the dedicated legislator and regulator find an ample supply of advisors who happily recommend how best to vote or act on particular issues. The reason that so much advice is forthcoming rests on a notion that economists call “rent-seeking” behavior (Buchanan, Tullock, and Tollison (1980)). By choosing one regulatory approach versus another, a politician can

transfer vast amounts of resources from taxpayers or consumers to the providers of politically favored services.

To illustrate, consider reducing automobile exhaust emissions. How might a regulator make this happen? One approach requires automobile producers to meet a performance standard without specifying how the standard is to be met. Under this approach, which requires monitoring air quality and auto emissions, environmental outcomes matter more than specification of inputs. Placing taxes on emission-generating fuels or on the emissions themselves is another approach. Again, air quality can be monitored and taxes raised or lowered to achieve environmental goals. Finally, the regulator can specify how emissions will be controlled and require all auto producers to follow the same technology-based rules. If one firm is already using the specified technology or has an advantage in building it, then there is no cost imposed on that firm. Instead, the regulation raises rivals' costs (Shalop and Sheffman, 1983). Ultimately, the U.S. EPA specified that all automobiles must have catalytic converters to reduce emissions, even if a particular automobile had little emissions. The converters relied on a technology developed by General Motors and brought profits to the patent owner. As air quality improved, GM made more money, and clean air lovers celebrated.

Capture theory may also explain how the railroads won the day when Congress empowered the Interstate Commerce Commission to regulate motor carriers in the 1935 (Motor Carrier Act of 1935. 49 Stat. 543 (1935)). This occurred after motor carriers began cutting prices for carrying freight and in spite of organized opposition from agricultural and other shipper interests (Felton and Anderson, 1989, p. 10). The rail interests were successful in forcing ICC controls on truckers.

But while capture theory seems to explain a good bit of regulation, it does not predict which party will capture when more than one is in the struggle, as is generally the case. For that, we must turn to the next theory of regulation. The special interest or economic theory of regulation was developed in the context of capture by the late Nobel Laureate George Stigler (1971) and his colleague, Sam Peltzman (1976). Professor Stigler suggested that one can make considerable progress in predicting which of several parties will prevail in a political struggle by imagining that the

specific content of proposed legislation is simply auctioned off to the highest bidder. By focusing on which parties have the most to lose (or gain) in the struggle, one can begin to understand outcomes. But this is just a first step in the process. In order to be a viable participant in the auction, the agent doing the bidding must know the consensus position of the group it represents. It is costly to organize an interest group, and the larger and more diverse the players, the greater the cost. Once organized, a consensus must be found regarding the policy outcome. And that is costly too.

Capture theory can be employed to explain how Eastern high-sulfur coal interests captured key members of Congress when the 1977 Clean Air Amendments were being developed (Ackerman and Hassler, 1981). These amendments required the use of scrubbers in newly built power plants for removing sulfur oxides from stacks even when cleaner low-sulfur coal from the western United States may have been used without scrubbers to accomplish the same end. Coal in the eastern United States coal was produced by organized labor, represented by the United Mine Workers (UMW) union; while cleaner Western coal was produced by nonunion workers.

Suppose the scrubber case had simply involved pitting Western against Eastern coal producers. The Eastern producers were located in relatively populous states and had been organized and working the halls of Congress for decades. They had more congressmen to confront and more supporting interest groups who wanted to keep local economies humming. The producers were not strictly homogeneous, some produced metallurgical grade coal and some were diversified across industries, but the industry was dominated by a small number of large producers. Eastern coal workers had also been organized for decades. When speaking to politicians, the voice of the United Mine Workers came through loud and clear.

Now consider the Western producers. These were comparatively younger firms with unorganized workers located in remote corners of less populous states. They had fewer congressional supporters and less support from local economies that might be disrupted. While the bulk of the market for Western coal was in the East, most consumers and voters were rationally ignorant about where their coal comes from. Pushed to pick which region mattered most, concentrated Eastern interests with a lot to lose outweighed scattered Western interests that had yet to enjoy the fruits of

an expanded market for their coal. Using this scorecard it is easy to predict Eastern interests would carry the day.

Northwestern Law School Professor Fred S. McChesney (1991) developed the fourth theory of regulation to consider. Instead of focusing on political favors that may be provided by politicians, McChesney develops a theory of political wealth extraction; it is damage control with a twist. Consider a group of businesses that have not yet been subject to regulation. The businesses are not organized politically, have no trade association, and provide little in the way of campaign contributions to politicians. In a sense, there is little a politician can do to benefit or harm an unregulated industry. To get the industry's attention, a politician announces that hearings will be held on the possibilities of calling for consumer protection regulation of the industry's main product or services. Several bills are drafted and some have rather draconian proposed rules. Hoping to deflect these pending costs, the industry organizes, hires lobbyists, and makes prudent campaign contributions to strategically important politicians. The politicians relax the threat somewhat, but leave a few clouds in the sky. Regulation has been avoided but wealth has been extracted.

Finally, as noted earlier, B&B explains how successful lobbying efforts and durable regulation emerge when one interest group, labeled the Baptists, takes the moral high ground while another group, the bootleggers, use the Baptists for cover as they pursue a narrow economic end. For the theory to work, both parties must seek the same end result, and it is clearly not necessary for the two interest groups to communicate or even show up at the same meetings.

The B&B theory combines elements of public interest and special interest theories of regulation and sheds considerable light on a large number of regulatory episodes. Consider for example America's grand experiment with Prohibition, which was finally passed into law in December 1917 after a long struggle by members of temperance leagues nationwide (Boudreaux and Pritchard, 1994). Prohibition hindered the production, distribution, sale, and consumption of alcoholic beverages. But two groups had reason to celebrate. Of course, those who favored Prohibition had good reason to cheer. They saw victory, especially when hundreds of breweries and scores of distillers in cities nationwide were dismantled. What about the bootleggers?

They had cause for celebration too. Indeed, according to data on alcohol consumption, average intake actually increased during Prohibition, but not from the same kinds of beverages (Gifford, 1977, p. 66). Beer consumption fell dramatically. The consumption of spirits rose just as dramatically. The cost of monitoring movement of beer barrels was much lower than the cost of tracking equivalent amounts of alcohol in bottles of Scotch and moonshine. And of course, if getting a given volume of alcohol was risky and therefore costly, it made sense to get it in more powerful forms.

There is another bootlegger lurking in the Prohibition story. Until 1916, the federal government received the majority of its revenues from taxes on alcoholic beverages. After entering World War I, the federal government needed more revenue and an income tax was imposed. The war experience taught the federal government about this reliable revenue source. Prohibition became affordable, and the politicians took the moral high ground. But then, something terrible occurred to the reliability of the income tax. The Great Depression arrived and with it, income tax revenues plummeted. With a government to run and shrinking income tax revenues, the politicians ended the grand experiment with Prohibition in February 1933. Meanwhile, the alcohol industry had been permanently restructured by the good cause, and spirits had become the drink of choice.

What regulation delivers

Regulations developed to address a perceived problem always generate benefits for some group and imposes costs as well. Sometimes, as in the Prohibition story, the costs and benefits are best seen in relative terms. Generally speaking, regulation is applied uniformly across firms and markets; there is a one-suit-fits-all outcome. But most of the time, there are substantial differences in technologies, products, and marketing practices across firms in an industry. Some players in an industry, or some consumers, gain a relative advantage. For example, Prohibition imposed higher costs on the beer industry and beer consumers than on the distilleries

and consumers of spirits and regulation redefined the contours of the industries and markets that were subject to the rules.

Firms are generally quick to recognize the gains that can be secured through regulation. Indeed, success in gaining just the right rules that raise rivals' costs may lead to higher profits than working to increase market share. In 2000, for example, John Deere, with the aid of environmental pressure groups, petitioned the U.S. Environmental Protection Agency to tighten the emission standards on small gasoline engine driven landscape appliances (Skrzyeki, 2000, p. C1). It so happens that the firm holds patents on a new cleaner engine technology. Deere can easily meet the stricter standards; its competitors cannot. Another interesting coalition emerged when major energy producers joined hands with environmental groups to support the Kyoto Protocol and proposed cap-and-trade legislation for reducing carbon emissions (Yandle and Buck, 2002, Yandle, 1999, Yandle, 2010b)

A somewhat similar situation developed in 2005 when the U.S. Department of Transportation announced new fuel-economy standards for large trucks and SUVs that had been popular with U.S. consumers (Meckler and Lundegaard (2005, B1)). (This was prior to the run-up in gasoline prices.) The newly proposed rules allowed vehicle producers to hit an average fuel economy within truck segments, as opposed to achieving an average economy outcome across all vehicles sold. Under the former system, General Motors and Ford, for example, had to sell cheaply some of their less popular, high fuel economy vehicles to offset the sales of their more popular, low fuel economy SUVs. The differential effects contained in the new rules improved the outlook for General Motors and Ford while taking away an advantage enjoyed by their rival, the Toyota Motor Company. (On fuel economy and B&B also see (Yandle, 2009a).

Similarly, Phillip Morris, with half of the U.S. market, wants the FDA to regulate marketing, advertising, and entry of new cigarette companies (Yandle, 2009c). In an earlier 2003 effort, Phillip Morris pushed for FDA regulation in an effort to gain federal regulation of health claims for safe cigarettes (Kaurman, 2003, p. A3). Like Deere in its effort to gain a regulatory advantage over its competitors by calling for stricter emission standards, Phillip Morris sought to raise competitor's cost

in making health claims. Not surprisingly, it turns out that Sen. Schumer was the top recipient of tobacco money of all senators seeking election in 2004.

One should not conclude that B&B theory applies only to the United States or to the modern age (Yandle, 2009b, Yandle and Buck, 2002, Yandle, forthcoming b). Howard Marvel's (1977) analysis of the 18th century English Factory Acts indicates that the law restricting the use of child labor was supported by the owners of the new water-powered mills. Those same owners were celebrated as enlightened reform social leaders. Even the 1225 Magna Charta contains a specification standard for the width of all woven cloth sold in the realm. The stipulation addressed a consumer protection problem, we are told, it also happened to fit the looms of the London weavers, who supported the rule, but not those in Norwich (Yandle, 1984).

Final thoughts

Lessons to be learned from theories of regulation cause us to consider economic interests when seeking to understand regulation and how the rules get formed. The theories say that politicians are like brokers who seek to balance competing demands for valuable political favors. But for the brokers to survive, the balancing act must generate benefits to interest groups that are appropriately situated. The Bootlegger/Baptist theory emphasizes that greater political demand emerges when public interest groups add demand to that of those who seek strictly private interests. The theory helps us to understand the particular features of regulation and how those features may change when “bootleggers” or “Baptists” choose to disappear from the invisible alliance that supported demand for regulation.

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¹ The author is Alumni Distinguished Professor of Economics Emeritus, Clemson University. Sections of this essay are taken from Morriss, Yandle, and Dorchak (2009).

² This was the key insight developed by James Buchanan and Gordon Tullock in their seminal piece, *Polluters' "Profit" and Political Response* (1975).