No. 08-24
August 2008

WORKING PAPER

RETHINKING PROTECTION OF COMPETITION AND COMPETITORS

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Introduction

1. Statement of the Problem

Regulation is often a form of corporate welfare that may end up making society worse off. Evidence shows that many regulations are supported by industry to force out competitors and raise competitors' cost. This behavior has the effect of raising prices for consumers and lowering the quality of goods and services they receive. In many cases, industries receive favorable support for their positions from consumer and environmental groups who may not be familiar enough with the industry to understand the anti-competitive effects of a particular regulation. What is often presented to regulators as a way to "level the playing field" in fact is a way of unevenly tilting the playing field (leveling the players in the field) in favor of those best positioned to influence regulatory bodies. Lost economic wellbeing is result of these anticompetitive activities. Modern economic science has focused on this problem for over three decades and has produced insights that can form the basis of policies that may reduce the losses associated with these problems.

2. Background for this Problem

From the Magna Charta's 13th Century specification of standards for cloth woven and sold in the kingdom (that just happened to match the looms of London weavers but no others), to the New London Colony's 17th Century rules on the baking of bread (that just happened to shuffle more business to particular bakers), to the U.S. Environmental Protection Agency's 2004 settlement with domestic medium diesel engine producers (that opened the door to larger market share for Mercedes, Volvo, and other European producers), government regulation seem inevitably to provide favors to some competitors at the expense of others.[1] In all three of these cases, strong arguments were made for providing consumer protection. But there were two effects to consider. The first are the direct or intended effects that may provide consumer benefits. From the standpoint of consumer welfare, these effects can be positive. The second are negative effects that may reduce or close out competition, chill innovation, and thus reduce consumer wellbeing. Carried to extreme, regulation's cartelizing effects may be entirely negative and seen as a form of corporate welfare.

When viewed strategically, competitors can use regulation to raise competitors' cost or shut out competition entirely.[2] Even antitrust law enforcement paradoxically can fall victim to anti-

[1] Economists refer to human action designed to gain political favors as rent-seeking behavior. For an excellent compendium on the topic see Buchanan, Tollison, and Tullock (1980). On the early history of the use of regulation to raise competitors' costs, see Yandle (1984). The diesel engine analysis is found in Morriss, Yandle, and Kosnick (2002). The three examples cited here illustrate Yandle's (1986) Bootlegger-Baptist theory of regulation, which argues that durable consumer protection and environmental regulation emerges when supported politically by one group (Baptists) that take the moral high ground and argue for consumer benefits and another group (Bootleggers) who seek the same regulation for financial gain.

[2] For an early but extensive review of this, see Federal Trade Commission (1984).

competitive behavior. By joining ranks with other producers, firms can use antitrust merger reviews as a way to fend off unwanted takeovers. Even more blatant blunting of competition emerges if firms in an industry call for federal action when competitors cut prices in a market battle to keep customer patronage. And while outright collusion by private firms to cartelize markets is generally prohibited by antitrust law, an even more durable result can be achieved legally through regulation.[3]

Regulation of all forms—social and economic—is a deeply engrained feature of modern life. Social regulation covers health, safety, and environmental quality and specifies how particular goods and services will be designed, produced, and sold.[4] Economic regulation deals with energy, finance, securities, transportation, and communication and specifies who will operate in designated markets and how products and services will be priced. Almost inevitably, it seems, every rule written can limit competition and affect the fortunes of industries, firms, and agents that compete in the regulatory process.

3. Quick and Not-so-Quick Solutions to the Problem

Can the goals of regulation—for example, safer cars, cleaner air, and more dependable energy supply—be accomplished without simultaneously compromising competition in domestic and world markets? Put another way, can the protection and improvement of consumer wellbeing generated by competition be assured in the face of growing regulation?

Through better guidance to agencies by the executive branch, agencies can be instructed by category of regulatory problem (where there is sufficient legal flexibility) as to which type of regulation will best enhance consumer welfare without restricting competition or innovation. For example, performance standards that provide incentives to compete can be described as preferred to "one suit fits all" command-and-control regulations that reduce competition. In addition, agencies can be instructed to identify not just overall benefits and costs but exactly which groups stand to win and which stand to lose if a given regulatory option is enacted. While the Office of Information and Regulatory Affairs (OIRA) may ask agencies to submit plans for significant enforcement actions that may have costs exceeding benefits, the executive order for regulatory impact analysis can be strengthened to determine where regulation induces domestic and global anti-competitive effects.

Competition can be introduced to regulation in other ways. In many cases, the goals of regulation can be enhanced by tort law or government-assisted quality assurance. In other cases, government as a low-cost provider of information may use its information-gathering and dissemination powers to enhance the operation of markets.

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[3] Cartelization of markets by agricultural producers is not just a legal option, but it required when USDA marketing orders dictate collusive action. U.S. antitrust agencies are prohibited from enforcing antitrust laws in the agriculture production sector.

[4] On this point, see the review of federal regulation activity by Brito and Warren (2007). They report that the 2008 budget request to fund regulator activity came in at $46.6 billion. Of this, 85 percent was for social regulation, which would employ some 215 thousand workers, and the remaining 15 percent for economic regulation, where there were some 35 thousand proposed employees (Brito and Warrant (2007, 5).

Finally, longer-term regulatory improvements may be provided through legislation that steers clear of technology-based standards entirely and encourages the use of economic incentives when regulations are to be written. Taking this tack will be particularly important for international standard setting. In all this, OIRA must play a critical role in assuring that competition is taken into account. OIRA can also specify the order in which regulatory options must be considered, thereby lifting up the relative importance of performance standards and economic incentives as compared to command-and-control regulation. In addition, future legislation can reinforce that order.

How These Proposals Will Help

By enacting these proposals, Congress and the executive branch can lower the overall cost of regulations substantially and facilitate increased competition in the regulated industries. Greater competition will generate lower cost goods and services and improved social wellbeing for U.S. consumers.

4. Recommendation for Enacting Solutions

By way of summary, the paper recommends that:

- Performance standards or economic incentives lay the foundation for regulation embodied in any legislative initiative. Technology-based, command-and-control regulation should be avoided where possible. The order of consideration for regulatory options should be required by executive order.
- A congressional regulatory review unit similar to OIRA be authorized to have oversight responsibilities for regulatory activities taken by independent regulatory agencies.
- The executive order be amended to require that agencies perform an assessment of the effects of major regulation on competition (overseen by OIRA).
- OIRA be authorized to require executive-branch agencies to obtain OIRA review of litigated settlements when the settlement includes regulation.
- All regulatory agencies be required to answer a second question before taking enforcement actions. The second question, which weighs the benefits and costs of acting, assesses the effect of enforcement on the competitiveness of the U.S. economy.
- All regulatory agencies be required to have an office devoted to efforts to reduce the cost of global regulation by harmonizing standards and reducing anticompetitive effects. That each agency be required to provide an annual report of such activities to OIRA.
- Agencies that develop voluntary standards license the use of an agency seal to be used on consumer products to signal agency approval, and to put the agency's brand name at risk.

5. Discussion of Solutions

To identify the solutions, this paper is organized by the following three specialized questions:

- How can the legislative process be reformed so as to give regulators more flexibility in achieving regulatory outcomes when interpreting directives from Congress?
- How can we assure that regulations designed to address competition and consumer protection focus exclusively on consumer welfare?

- Given the growing importance of global trade, what is the best way to promote trade by reducing costs of compliance with multiple sets of regulatory rules from different countries?

These three questions form sections of the paper. Brief final thoughts conclude the paper.

A. How can the legislative process be reformed so as to give regulators more flexibility in achieving regulatory outcomes when interpreting directives from Congress?

When legislation is written to achieve a particular regulatory goal, how industries and firms are regulated can provide incentives for affected firms to behave anticompetitively. This may result from firms using regulatory agencies as an instrument for limiting competition (by for example, raising existing or potential rivals' costs) or by persuading agencies through the use of differential standards to block entry of new competitors. Some regulatory instruments provide greater opportunities for anti-competitive behavior than others. Even when inducing competitive responses in the domestic economy, regulations may reduce global competition and stifle innovation. The choice of regulatory instrument—listed here from most- to least-restrictive—will determine the outcome. Broadly speaking, the choice of instruments includes the following options:

- Technology-based, command-and-control regulation
- Economic incentives (fees and taxes)
- Cap-and-trade
- Requiring information/labeling
- Performance standards

Technology-based, Command-and-Control Regulation

The U.S. Clean Air Act and Federal Water Pollution Control Act, which originated in the early 1970s, provide classic examples of technology-based, command-and-control regulation. These two acts instruct the U.S. Environmental Protection Agency to define best available, best practicable, and other specified technologies that, when installed and operated, will reduce otherwise uncontrolled emissions by predictable amounts. Once specified by the agency, every firm in a regulated industry, generally speaking, must apply the specified technology fix to designated discharge points. The clean air and clean water legislation carries command-and-control one step further by requiring differential treatment of old and new pollution sources.

This regulatory package establishes enormous potential gains for firms and industries that successfully influence the choice of technologies to be required across the industry. Operators of existing plants are given an additional incentive to influence the selection of stiffer standards for newly constructed pollution sources built by competitors. From a firm's standpoint, an appropriately designed technology standard can raise competitors' cost. Indeed, if a firm is successful in imposing its own practices on other firms that operate differently, the successful firm will encounter no cost effects. Like the London weavers, the resulting rule will raise competitors' cost. This enables the favored firm to gain market share and additional profits. From an industry's standpoint, an appropriately specified differential standard for new sources can reduce future output growth and enable higher prices and profits to be sheltered by regulation.

When Congress specifies technology-based, command-and-control regulation, the regulator is constrained to adopt particular regulatory solutions. Once in place, the resulting rules can effectively cartelize industries and protect existing firms from new competition. The approach may indeed reduce pollution or some other unwanted risk, but in the process may weaken the beneficial effects of competition and the longer-run ability to install cleaner or safer technologies. This regulatory choice freezes technologies that may be used for pollution control or other risk reduction purposes, reduces the search for cleaner and safer production processes, raises prices consumers must pay for the goods they purchase, and, unless otherwise blocked, invites competition from global producers who can produce at lower cost. When combined with differential standards as between new and old sources, command-and-control further cartelizes affected industries and imposes even greater losses on consumer welfare. Again, it is possible, of course, for unwanted pollution or other risks to be reduced. There can be gains on one side of the consumer wellbeing ledger while there are losses on the other side.

Command-and-control regulation emerged in the 1970s during America's smokestack era. This was a period when heavy manufacturing dominated the industrial scene, when one set of rules for steel making, foundries, and copper smelters might be devised and required across somewhat homogeneous industries. Whether the problem to be addressed was pollution, worker safety, safer lawn mowers, or more efficient appliances, Congress more often than not moved in the direction of technology-based standards. The smokestack era has passed, but smokestack regulations and their high potential for anti-competitive effects are still with us.

Economic Incentives

Using taxes and fees as a way to ration undesired activities generates an entirely different set of incentives. For example, instead of telling industrial users of treatment services how to construct their plants, most municipal operators of sewage treatment plants require industrial firms that discharge into sewer lines for later treatment to pay a fee based on the costs of treating the discharged waste. The higher the fee, the more likely the discharger will pretreat waste or reduce discharge entirely. The fee provides a powerful incentive to protect environmental quality. California's South Coast Air Quality Control Region uses emission fees, along with the required federal technology, as a way to reduce unwanted emissions and at the same time generate revenues for operating the regulatory agency. Affected firms in the South Coast region are given a fee schedule. More emissions mean higher total payments to the regulator. Higher fees encourage polluters to clean up more. The same outcome produced by command-and-control can be achieved by charging fees. The agency does not tell a firm how to reduce emissions and does not charge different fees for new and old sources. This use of economic incentives is neutral. It neither protects competitors nor reduces competition.

In a much celebrated early 20th century example of the use of economic incentives, water pollution in the Ruhr River basin was controlled by charging effluent fees. Discharge was reduced and the environment was improved. The resulting revenues were used to build water treatment plants and in other ways improve the region's environment. Waste discharging firms seeking to locate or expand in the region were given a price schedule that would determine the amount to be paid per unit when discharging into the river. The fee system gave firms an incentive to find low-cost ways to avoid discharging waste. The system encouraged the discovery of superior technologies, harnessed competitive forces to improve the environment, and did not reduce competition in product markets. The use of economic incentives reduces unwanted pollution, which provides consumer benefits, without imposing costs on the other side of the consumer ledger. Of course, the potential use of economic incentives extends far beyond

environmental regulation. Fees based on excess occurrence of accidents or product defects in consumer goods can be devised to substitute for technology-based standards, thereby avoiding the technology-freezing aspect of command-and-control.

Emission fees and taxes focus on outcomes, not on inputs. They seem to be more adaptive to a diverse economy that is not dominated by heavy industry. With economic incentives, the regulator must emphasize monitoring performance, and measuring overall outcomes. They tend to preserve consumer benefits that spring from a competitive marketplace.

Cap-and-Trade Regulation

The U.S. approach for limiting sulfur dioxide emissions in the nation's eastern half provides an excellent example of cap-and-trade regulation. The legislation that spawned this regulatory approach instructed EPA to develop regulations that would reduce total emissions by a specified amount and to allocate the reduction burden across coal-fired electric utilities roughly on the basis of emissions in an earlier baseline year. Plant operators have the option of reducing emissions at the plant level to meet the target or paying a plant in a different location to make reductions beyond its allocated reduction burden. The cap-and-trade process spawns a search for lower-cost ways to reduce sulfur dioxide emissions. By its very nature, cap-and-trade is an output restriction; it does lead to an output reduction, which means higher prices will be charged for electricity. But the instrument itself provides profit opportunities to firms that produce more emission reductions and penalizes those that produce fewer reductions. The instrument does not inherently raise competitors' costs or impede entry of new competition. Prior to implementation of cap-and-trade legislation, Congress required coal-fired utilities to install scrubbers on all newly constructed plants, even if the plant could achieve clean air goals by burning low-sulfur coal. The former technology-based approach eliminated competition from low-sulfur coal producers, required installation of a particular high-cost technology and thereby reduced incentives to discover lower-cost ways to produce cleaner air.

Cap-and-trade induces competition for cleaner production, leads to the discovery of the lower cost producers of clean air, and puts a market-determined price on expansion of output by new or existing firms. All producers must abide by emission output constraints. Pollution and output is reduced, but the competitive search for pollution reduction approaches tends to minimize the cost of achieving the regulatory goal.

With cap-and-trade, the regulator is challenged to determine a baseline level of pollution or unwanted risk to reduce. Because of the baseline problem, cap-and-trade is more likely to be applied across well identified large producers of pollution or risk. Once the regulations are in force, the regulator must focus on outcomes. The regulator's burden has to do with monitoring and enforcing the regulations.

Requiring Information/Labeling

Requiring firms to provide point-of-sale and label information is common place for many consumer goods. For example, instead of specifying standard recipes for food products and over-the-counter drugs, regulatory agencies require listing of ingredients and nutrition content. In some cases, the agency specifies a glossary of terms that must be used in developing labels and advertising language. The U.S. Department of Energy requires producers of certain electrical appliances to give an estimate of annual energy use; the U.S. EPA requires auto companies to label prominently the fuel economy expected for new cars based on EPA testing; and the Federal Trade Commission requires textile and apparel product manufacturers to

provide permanently attached care labels for consumer products. In these cases, the regulator takes on the technical burden either of being the source of the information or approving informational content. While generally less restrictive on competition and the ability to innovate than technology-based standards, there is always a risk that open market competition will be biased in favor of certain producers. Because of this risk, there is another option to consider: regulators may choose to adopt a voluntary approach for improving consumer information. The wide-spread use of ecolabels in the European Union is an example. These labels attempt to signal products that have a low environmental impact. To secure their use, a producer must provide technical product information that is then compared with government-approved standards to see if the product satisfies the standard. No producer is required to meet the environmental standard. There is competition between labeled and unlabeled products.

Performance Standards

If Congress wishes to achieve a particular regulatory goal, performance standards provide the simplest possible approach with the least anticompetitive baggage. Instead of specifying how to accomplish a goal, performance standards announce the goal to be achieved, describe how results will be measured, and stipulate penalties to be imposed for regulatory failure. Competition takes over from there. Of course, Congress can write performance standard legislation that specifies different standards for particular products or sectors and in so doing induce anticompetitive effects. Corporate average fuel economy (CAFE) standards provide an example of performance standards and also illustrate how differential performance standards can be used to raise competitors' cost. Let us first consider the general case. When CAFE standards were first required for new cars sold in the United States, Congress specified an outcome to be achieved, this instead of instructing the U.S. Department of Transportation to specify the kind of engines, carburetors, and ignition systems that might accomplish the same goal. In fact, Congress specified the end-period standard to be met for the U.S. new car fleet and instructed Transportation to specify standards for intervening years.

Since the pace for achieving performance standards was determined in the resulting rulemaking, competitors could behave strategically in lobbying for reduction timing that favored them. For example, firms with a high mileage fleet would favor heavier fuel economy gains early. Those firms already meeting the fuel economy standard faced no new costs. Those performing below the standard had to alter the design of their vehicles to meet the standard. But the redesign was unconstrained. Producers could change ignition, weight, fuel, tires, and other vehicle features to gain fuel efficiency. Competitive forces played through the process. Because of their initial positions, model mix, and technical advantages, some firms achieved the standard at lower costs than others. Of course, the fuel efficiency standards were not quite this simple. There were different rules for domestic versus foreign fleet and trucks versus cars. This meant the regulators had to define what constituted a truck versus a car and what a domestic versus a foreign produced car was. As it turned out, SUVs became hugely popular because CAFE standards for trucks were set lower and SUVs more readily satisfied consumer demand for larger higher powered vehicles. In the final analysis, CAFE standards induced differential effects across vehicle types, manufacturing firm specialization (large versus small vehicles), and domestic versus foreign producers. In addition, and most controversial of all, implementation of CAFE standards led to lighter, less-safe automobiles and, as a result, an increase in highway fatalities.

Despite the effects of the CAFÉ standards, performance standards generally have the advantage of being neutral with respect to particular firms and technologies in use. When applied without special treatment for some product types or domestic versus foreign producers,

performance standards bring no particular bias to the marketplace. They induce competition at every margin. One can easily imagine what might have happened if the Clean Air Act, for example, had been based on performance versus technology-based, command-and-control standards, which was the approach used in the earlier versions of the act developed in committee.[5] A case can be made that clean air goals would have been accomplished sooner and at much lower cost. The same statement can be made for safety and health legislation that call for technology-based standards.

Performance standards are better suited for a highly diverse economy that is not dominated by easily targeted large industries; they seem far better suited for America's service economy than the other regulatory instruments. The critical elements that need to be in place for a performance standard to work are a well defined standard and a readily measurable metric to monitor and report progress toward meeting that standard.

Regulatory Options Order

In general, agencies should always examine the existing market and regulatory structure not just to have a sense of the existing problem, but to assess how the market is likely to evolve in the near future. In many cases, by the time a regulatory agency is aware of a problem and can actually act on the problem, the market will generally move ahead of the agency. Next, the agency should consider providing guidance on how market participants may solve the problems themselves based on the agencies research and expertise. If, in fact, the agencies do not believe that solutions exist, they should consider not regulating in favor of investing in research to discover solutions. Third, as mentioned in the appendix to this paper, agencies should consider encouraging or actually engaging in facilitated market solutions. Fourth, agencies should consider mandatory provision of information to solve social problems. Following these options, agencies should consider in order, performance standards, cap-and-trade rules and economic incentives. As a last resort, if none of these solutions are workable to achieve the regulatory objective, specific requirements (command-and-control) should be considered.

B. How can we assure that regulations designed to address competition and consumer protection focus exclusively on consumer welfare?

The discussion of incentives for anticompetitive behavior illustrates how regulations designed to provide consumer benefits, e.g., cleaner water or a safer work place, can simultaneously reduce welfare along another dimension by chilling innovation and by reducing competition and competitive entry. The question for this section asks how, given these prospects, regulatory procedures can be improved so that the potential for welfare losses can be minimized. Lessons drawn from the previous section suggest that, broadly speaking, Congress should focus more on the goals of legislation that will benefit consumers than on the precise means for achieving the goals. This suggests avoiding technology-based standards and encouraging the use of performance standards or economic incentives when regulatory legislation is being written. Then, in the development of regulations spawned by legislation, regulatory review should include an assessment of effects on consumers that includes the effects on competition—both domestic and global—and on innovation. Another step to be taken in assuring that regulation will generate overall consumer benefits relates to actions taken by regulatory agencies when exercising discretion as to which enforcement actions to take. This latter point is relevant to all regulatory agencies when they undertake enforcement actions. In any case, the prospects for

[5] On this, see Whitaker (1976).

fostering changed behavior will rely on a combination of legislative and executive branch actions. Whether written into law or initiated by presidential executive order, regulators can be instructed to ask a second question—What about competitive effects?—before initiating actions intended to protect consumer welfare.

Asking a Second Question When Regulating

Regulatory agencies may provide consumer benefits by issuing new rules and enforcing existing rules. In either case, the agency must demonstrate the legal authority to act, which is to say any action taken must be consistent with the agency's statutory authority. Assuring this to be the case relates to the first question to be answered. If the matter relates to issuing a new regulation, the agency must show that Congress authorizes the action. The question for the regulator is this: Are we authorized to initiate a rule? When proposing new rules that have a substantial effect on the economy, executive branch agencies must pass muster with OIRA's regulatory review authority stems from executive orders that have evolved since the Ford Administration initiated the first regulatory review process in 1974. Current OIRA authority rests on amendments to Executive Order 12866 issued by the Clinton Administration in September 1993. It is noteworthy that the order requires agencies to "identify and assess available alternatives to direct regulation, including providing economic incentives" and to consider "incentives for innovation." The order goes on to require that agencies "to the extent feasible, specify performance objectives, rather than specifying the behavior or manner of compliance that regulated entities must adopt." However, the current executive order does not emphasize taking account of effects on competition as did the original Ford Administration order issued in 1974. (E.O. 11821, November 27, 1974, which stated: "the Director must consider . . . [the] effect on competition.") To recognize the critical importance of the potential anticompetitive nature of regulation, the OIRA executive order should be amended to stipulate that agencies address the second question: They must make a separate and distinct assessment of the effects of a proposed regulation on competition, domestic and global. The order should be further amended to require agencies to provide a final tally of the total welfare effects of a proposed rule that takes account of the expected net benefits to consumers and the negative effects, if any, generated by reduced competition.

Even if OIRA's review process is strengthened by asking the second question, there is still work to do. OIRA's required reviews apply only to executive branch agencies. Independent agencies such as the Federal Trade Commission, Federal Communications Commission, and Consumer Product Safety Commission are not included in the review process. Recognizing that independent agencies cannot be made subject to OIRA's demands requires development of a second review procedure. This could involve adding a regulatory review process to the responsibilities of the Congressional Budget Office (CBO), what some have called a Congressional Office of Regulatory Analysis (Hahn and Layburn, 2003).[6] If this approach were taken, it would be helpful if the CBO would establish review requirements similar to those of OIRA. Yet while CBO would not have the same administrative authority that OIRA exercises in requiring responses from executive branch agencies, CBO could be required to publish its

[6] Hahn and Layburn (2003) suggested that the Congressional Office of Regulatory Analysis would be given all-encompassing oversight responsibilities for assessing the impact of regulatory activity at all regulatory agencies—executive branch and independent agencies. Separation of powers suggests that two review agencies may be required, one for independent agencies and the current OIRA, which is responsible to the Executive Branch.

reviews and provide recommendations to congressional oversight committees. Requiring this CBO activity would bring parallel treatment and equal transparency to regulatory actions taken by independent regulatory agencies.[7] The beneficial effects of public debate and discussion would follow.

Asking a Second Question When Enforcing Regulations

If the matter is enforcement of existing regulations, the agency must demonstrate first that the law has been broken. The second question in enforcement matters requires the agency to confront the consequences of the action it may take. Will the expected benefits of action be greater than the costs imposed by taking action? Speaking to the question requires giving consideration to the resource cost expended by the agency in bringing action and the costs imposed on the economy including the competitive effects. Given scarce agency resources, there will always be more opportunities to go after rule violators than there are resources for doing so. An additional problem arises when competitors attempt to blow the whistle on competitors in the hope of raising competitors' costs.

Enforcement of the Robinson-Patman Act is an example of using regulation to reduce competition. This piece of antitrust legislation addresses price discrimination, which can be broadly interpreted as cutting prices for one customer or group of customers but not for all. There are defenses, of course, but it is clear that when firms complain to antitrust authorities about their competitors, it is highly likely that something other than consumer harm is at stake.

When taking enforcement actions, it is possible for agencies to arrive at settlements that actually involve more industry-wide regulation. This activity goes by the name of regulation by litigation. Asking the second question here requires the agency to justify its action in a different way. If the intended outcome is regulation, then the agency should be required to use traditional notice and comment regulation instead of the courts. Traditional regulation provides due process opportunities for all interested parties to participate in the regulatory process.

When enforcement actions are large enough to impose significant costs on the economy, OIRA should be authorized to require executive branch agencies to submit their plans for OIRA review. This is critically the case if the agency is engaged in regulation by litigation. Then, following on the earlier recommendation regarding new duties for the Congressional Budget Office, independent agencies engaged in significant enforcement actions should be required to submit their plans to CBO for review.

Asking the second question is as important as asking the first question. Doing so requires agencies to justify their actions on the basis of their effects on all dimensions of consumer wellbeing. By including independent agencies in regulatory review processes, incentives for greater sensitivity to consumer wellbeing are provided. Accountability and improved transparency is assured.

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[7] William Niskanen (2003) suggests making a fundamental change in the authorization of regulatory agencies, which would remove their capability to promulgate rules after notice and due process procedures. He argues that since regulations are laws, congress should review all proposed regulations and then have an up or down vote on any rule a member recommends for action.

C. Given the growing importance of global trade, how can we ensure that consumers are protected without protecting competitors or hobbling productivity and innovation?

Recent events involving unexpected low quality of imported consumer products in U.S. markets brings to fore the importance of quality assurance for global trade. Events such as the discovery of lead in imported toys and pathogens in imported foods are newsworthy because these events are rare relative to the overall volume of imported products. Nonetheless, any unfortunate harm that befalls consumers also reminds us that quality assurance can be improved.

How can quality assurance institutions be strengthened in ways to maintains competition while expanding global trade opportunities?

Quality-Assurance Institutions

Consumers walking into a large American supermarket seldom if ever seem nervous about the safety of the food on the shelf or in bins, even when food items are fresh and open for inspection by passersby. In what might be thought of as a modern miracle, millions of consumers daily bring home the goods, prepare them, consume them, and enjoy good health. For the most part, while government intervention plays a vitally important role in meat and dairy products, most quality assurance is driven by private market forces. A similar statement can be made regarding other consumer items, such as automobiles, clothing, furniture, toys, and appliances.

The vast quality assurance network that affords remarkable consumer protection includes:

- Market competition
- Brand name capital
- Financial market monitoring
- Liability insurance
- Common and code law
- Private certification and inspection services
- Government regulation

Private Market Quality Assurance

Open market competition is the strongest force in the web of mechanisms that work to assure marketplace quality. Through the process of buying and using products, consumers make choices, become informed, and reward with patronage those sellers who provide goods and services that satisfy their needs. Firms that produce shoddy merchandise will not be successful with repeat consumers who seek goods that have predictably higher quality characteristics. The easier it is for consumers to walk away from unsatisfactory providers, which is to say the greater level of competition for consumer patronage, the more readily the supply of higher quality goods. When competition is limited, for whatever reason, consumers stand to suffer.

Brand names in the marketplace provide quality assurance, even when competition is less active. Firms (and individuals) invest in their brands through advertising and other selling

expenditures. The delivery of faulty products can reduce or even destroy the value of the brand investment. Steps taken by firms to assure quality protects the value of a major asset.

The brand name of sellers can replace product brand names when it is difficult for consumers to monitor or identify producer reputations. Major big box retailers such as Lowe's, Home Depot, Wal-Mart, Penney's, and Sears bring hundreds of thousands of items under their roofs and offer guarantees to assure quality. Once the seller's brand name is put at risk for one item, it is at risk for every item. Major retailers will then represent consumers in insisting on the delivery of quality assurance from suppliers. This is the case whether the supplier is local, national, or international.

The same is true of upstream suppliers. Food manufacturers buy ingredients from both domestic and international suppliers. Unlike the FDA, which inspects food plants at most once a year, some food plants are inspected by upstream suppliers (and insurance companies) once a week and the standards for inspection usually far exceeds that set by the government. It is private market contracts and inspections that primarily drive food safety and quality.

The quality assurance effects of competition and protection of brand name capital are further reinforced by credit card issuers and financial markets monitoring. Credit card companies provide guarantees to consumers in the sense that consumers can refuse to pay for items they find unsatisfactory. The credit card company then brings pressure to bear on the seller. Financial markets put indirect, but heavy pressure on firms that produce faulty goods and services. Stock exchange listed producers and sellers are put at risk by the market. Investors are risk averse. They dislike bad news, whether it is about earnings, law suits, or product recalls. When bad news surfaces, investors tend to sell their shares and ask questions later. The selling of shares reduces equity values, raises the cost of capital, which makes it more difficult for the punished firm to expand.

Of course, firms can and do purchase insurance to reduce exposure to the unfunded risks of poor performance. When they do, there is yet another quality monitor looking over the shoulder of managers. Insurance companies add another element to the web by requiring quality-assuring behavior.

Competition, brand-name capital, credit card companies, financial markets monitoring, and insurance combine to bring quality assurance to the market place. Even so, there are yet other mechanisms at play.

Common law provides one of the oldest protections to U.S. consumers. When a seller fails to deliver the quality promised or expected, consumers may have a cause of action against the seller. Of course, bringing suit is not inexpensive, but the threat is real, especially when many consumers have been harmed by a seller's failure to provide goods and services as promised. Where the scope and magnitude of harm is large, lawyers who specialize in mass-tort cases can organize and fund action on a contingency-fee basis. In some cases it is difficult to establish cause, such as in food poisoning that results from consumption of a food from two hours to two months earlier (*listeria monocytogenes)*.

Agencies that are typically charged to duplicate the services of private markets may be better employed by analyzing the effects of these market activities and determining where their competitive advantage is in ensuring safety or quality. In many cases, this may be in the creation and dissemination of information. In some cases, where there are insufficient incentives

in the private market for collection of information, or government has a cost advantage in doing so, this may enhance these markets. This is further discussed in the section below.

There is yet another category of private activities to consider. These are credentialing organizations like Underwriters Laboratory, Good Housekeeping, the Better Business Bureau, chambers of commerce, and other organizations that make an additional brand available to providers of consumer products who meet their quality standards. To these are added international organizations like the International Organization for Standardization (ISO, www.iso.org), a non-governmental organization headquartered in Geneva that coordinates and harmonizes standards for goods traded in global markets. ISO is a network of the national standards institutes of 157 countries. ISO provides certification to firms that meet ISO standards. Inspection services firms are a last example of quality assuring organization. These for-profit businesses inspect and certify and guarantee products, processes, and construction. SGS, which is also located in Geneva, Switzerland, (www.sgs.org) is one of the largest and most globally extensive of these firms.

Finally, there are a host of product-specific and general consumer product magazines and publications that test, review, and rate consumer products. *Consumer Reports* is perhaps the best-known example of this.

Government-Assisted Quality Assurance

Government-assisted quality assurance comes in several forms. For example, the U.S. Consumer Products Safety Commission (CPSC) provides technical guidance to firms by (1) developing technical standards and regulations for consumer goods that run the gamut from dart boards, baby beds, bicycles, toys, electrical appliances to household cleaning compounds and beyond and (2) giving guidance for voluntary standards developed by various standards organizations such as the American National Standards Institute (ANSI) (www.ansi.org). ANSI is in turn a member of the International Organization for Standardization. As can be seen by the example, CPSC affects standards for products produced and sold in the United States and also indirectly influences product standards that may be adopted by international producers in the global market place.

Along with other regulatory powers, the CPSC has authority to force product recalls, to impose fines, and to ban the sale of products determined by the agency to be high risk.

The development of voluntary technical standards leaves room for some cartel effects where larger firms dominate the process but softens the possibility by allowing for innovation across firms that may opt for taking an alternate approach. Singapore, for example, encourages quality assurance in consumer markets by licensing firms that meet the state standard to display a prominent seal of approval on their products. Firms that do not choose to have their products certified can compete head-on with government-approved products. The government regulators expect products with government seals to command a higher price. When that does not happen, the regulators assume that their seal has not added value, and may therefore be calling for product attributes that are not valuable in the eyes of consumers. Feedback from the market leads to review of government standards.

U.S. regulatory agencies that coordinate development of voluntary standards should provide a licensed seal to be used on consumer products that satisfy the standard. The seal of approval signals enhanced value to consumers and places the agency's brand name at risk.

Participation by U.S. regulatory agencies in international standard-setting activities provides an important opportunity to push for taking more flexible approaches. As noted earlier, performance standards provide the greatest incentive for firms to engage in a never-ending quest for low-cost ways to meet outcome-based consumer protection goals. The use of performance standards also reinforces competition and completely avoids the possibility of generating regulatory cartels. But this comes with an administrative cost. The enforcement of performance standards means that the regulator must observe performance data and impose fines when performance is not forthcoming. Obviously, the expected value of the fines must be large enough to cause firms to choose performance instead of avoidance. Of course, technical standards have to be enforced also, but where there are cartel effects there is an incentive internal to industries to cooperate with the regulator's enforcement efforts.

With globalization expanding to the limits of market capabilities to produce and ship goods across world markets, the work to harmonize quality standards by organizations like the World Health Organization, the Food and Agriculture Organization of the United Nations, and the World Trade Organization becomes critically important. These companion consumer organizations and private standards organizations are interacting to harmonize standards that will be met by producers worldwide.[8] This quality assurance web should be encouraged explicitly by Congress when writing any form of consumer protection legislation. Each U.S. regulatory agency should be required to have an office devoted to participation in cooperative efforts to reduce the burden of regulations affecting goods and services exchanged in world markets and in the process work to harmonize standards and assure that standards are met. In every case, the effects of actions taken on competition must be explicitly considered. Each regulatory agency should be required to report on these activities to a regulatory review group, either OIRA or a review group that oversees independent regulatory agencies.

Final Thoughts and Additional Long-Run Research

This paper has reviewed public and private regulatory procedures that have been developed to assure that markets will delivery higher quality, lower-cost goods and services to consumers. The scope of activities is as vast and varied as the participants that operate in global markets. The paper began with a warning: Efforts to improve human wellbeing through regulation can weaken competitive forces to the point that consumers may actually be made worse off. The analysis that followed focused first on the incentives included in the various regulatory approaches that government might develop for accomplishing a given regulatory goal. The incentive-based analysis then recommended that government always attempt to avoid specifying technology-based standards and to favor goal-oriented rules that focus on outcomes not on regulatory inputs.

The discussion of regulatory processes noted that independent regulatory agencies operate outside the important regulatory review process required of executive branch agencies. Development of a regulatory review process within the Congressional Budget Office or as a separate congressional unit would close the regulatory review circle and raise the accountability of independent agencies to the public they seek to serve. When agencies decide to act, whether in issuing new rules or enforcing old ones, the analysis recommends that a second question be asked before taking action. The question focuses on the costs and benefits of the action that includes taking account of the effects of the action on competition in the marketplace.

[8] See Groth, 1999.

Finally, the discussion of how to improve quality assurance in the global marketplace reviewed the complex web of quality assurance mechanisms that now operate across markets, regions and countries. This review highlighted the importance of clearing houses, conferences, and nongovernmental agencies that together bring improved consumer protection.

Competition among firms, governments, and government agencies can together provide improved human wellbeing. Regulatory actions taken to address important problems consumers face either can strengthen or weaken competitive forces. When regulation is considered, critical attention should always be focused on the extent to which the benefits of regulation will be large enough to offset any anticompetitive effects the regulations may generate.

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