

Book Reviews

Who Wins the Regulatory Game?

Who Profits: Winners, Losers, and Government Regulation, by Robert A. Leone.* New York, N.Y.: Basic Books, 1986. 244 pages. \$17.95.

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The unsuspecting purchaser of Robert Leone's *Who Profits: Winners, Losers, and Government Regulation*¹ (without a question mark) might think he is going to glean some new estimates or theory of the distribution of gains from government regulation. How much does regulation cartelize industry or labor?² How much does regulation protect domestic industry from foreign competition? Or established firms from new competitors?³ Do consumers gain at the expense of business, or vice versa? Are the interests of consumers, businessmen, and regulators to some extent identical, and if not, at what point do these interests diverge, and why? In terms of both efficiency and fairness, whose interests are considered the touchstone for evaluation of any given regulatory change?

Surprisingly, Leone answers none of these questions. This book is not an attempt to measure "who profits," but is instead a short handbook to help private decisionmakers and public policymakers cope with the fact

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1. R. LEONE, *WHO PROFITS: WINNERS, LOSERS, AND GOVERNMENT REGULATION* (1985) [hereinafter by page number].

2. The "capture" theory of regulation, which suggests that regulatory agencies do not remain independent but instead are captured by special interest groups and then reinforce this cartelization, has been prominent in the economics literature since the 1960's. For a review of the literature, see B. MITNICK, *THE POLITICAL ECONOMY OF REGULATION* 206-39 (1980); Joskow & Noll, *Regulation in Theory and Practice: An Overview*, in *STUDIES IN PUBLIC REGULATION* (G. Fromm ed. 1981). See also *infra* text accompanying notes 10-15.

3. An early analysis of regulation as a barrier to entry in competitive markets is contained in Moore, *The Purpose of Licensing*, J.L. & ECON. 93-117 (1961). More recently, important work in this area includes R. NOLL & B. OWEN, *THE POLITICAL ECONOMY OF DEREGULATION: INTEREST GROUPS IN THE REGULATORY PROCESS* (1983).

that government policies create winners and losers. It is, in short, a "how-to" guide for players in the game that Public Choice theory might call "the private use of the public interest." Leone's book neither adds to nor expands upon the theory of public choice or rent-seeking behavior; his book is rather a product of such behavior. In its structure, organization, and content, *Who Profits* avoids the general economic and political implications of regulatory policies.

I. The "Iron Law" of Public Policy

Leone's message is rather straightforward. There is an Iron Law of Public Policy: Any regulatory policy, however socially beneficial or wasteful, creates winners and losers.⁴ It is important for businessmen to recognize this fact and to adapt themselves in a fashion that assures *they* are not the losers. Similarly, policymakers must also recognize the Iron Law and the way businesses adapt to it if they are to design and execute policies that serve the public interest.

The book is divided into two sections: (1) Understanding Competition When Government Matters⁵ and (2) Understanding Government When Competition Matters.⁶ The first section might be part of a casebook for a business school course on government regulation of business. The second begins as a business school course in business strategy and concludes as a primer for a public policy school course. Leone, formerly Senior Economist for the President's Council of Economic Advisors and currently a lecturer at Harvard, has undoubtedly taught all three courses, on both sides of the Charles River.

Had Leone treated the problem of regulation with equal respect for the short and long term concerns of businessmen, policymakers, and the public in general, he might have illuminated some of the trade-offs and choices implicit in any regulatory policy. However, his project is to offer strategic suggestions to private businessmen and policymakers. This limits his concerns to the tactical and his perspective to the technical. Despite Leone's claims of objectivity and lack of "ideology,"⁷ he seems to endorse the outcome of these regulatory games between businessmen and bureaucrats.

The first section begins with an admonition to ideologues. According to Leone, both conservatives and liberals fail to come to grips with the

4. P.3.

5. Pp. 3-110.

6. Pp. 112-229.

7. P. 7.

essence of government regulation.⁸ Conservatives generally do not understand the potential benefits of regulation; liberals simply want to control business without considering the complex, long-run effects of such policies on the economy. In the next chapter,⁹ we are given another reason for eschewing ideology: Regulation is inevitable and pervasive. We had better understand its intricacies and learn to adapt to it rather than fighting it or promoting regulation as an end in itself. This might seem a strangely stoical perspective on government from a former policymaker, but it does have the virtue of allowing Leone to avoid the complex Public Choice issues that would arise should he attempt anything other than a tactical approach.

Little is original in this first section. Certainly, readers of Kolko,¹⁰ Downs,¹¹ Olson,¹² Buchanan,¹³ Peltzman,¹⁴ Stigler,¹⁵ and analysts of regulation know that private firms can and do reap substantial rents from government policy. Much of the earlier literature on government regulation concluded that regulatory commissions often cartelized sellers who would otherwise be subject to competition and threats of new entry. Leone's emphasis in this section, however, is on the newer forms of regulation: environmental,¹⁶ health and safety,¹⁷ and mandated fuel efficiency.¹⁸ Unfortunately, he does not attempt to enhance our understanding of these newer forms by analyzing them in light of the earlier theory. In particular, it would have been interesting for Leone to have tested the implications of the early Public Choice Theory. As a predictive matter, are these newer regulatory policies consistent with the earlier paradigm's description of the interplay of government and interest groups? Can the insights of these classic papers be easily extended to the newer forms of regulation? Or do the newer regulatory forms reflect changes in the regulatory game that demand extensive revision or reconsideration of these early insights?

My own impression is that the growth of the new social regulation only partially reflects the interaction of narrow private interest groups, but that

8. Pp. 7-15.

9. Pp. 22-29.

10. G. KOLKO, *RAILROADS AND REGULATION: 1877-1916* (1965).

11. A. DOWNS, *AN ECONOMIC THEORY OF DEMOCRACY* (1957).

12. M. OLSON, *THE LOGIC OF COLLECTIVE ACTION* (1965).

13. J. BUCHANAN, R. TOLLISON & G. TULLOCK, *TOWARD A THEORY OF THE RENT-SEEKING SOCIETY* (1980).

14. Peltzman, *Toward a More General Theory of Regulation*, 19 *J.L. & ECON.* 211 (1976).

15. Stigler, *The Theory of Economic Regulation*, 2 *BELL J. ECON. & MGMT. SCI.* 3 (1971).

16. *E.g.*, pp. 189-93 (discussing Best Conventional Technology criterion for industrial control of water pollutants).

17. *E.g.*, pp. 52-53 (discussing Consumer Product Safety Commission establishment of safety standards for chainsaws).

18. Pp. 36-37, 41-42, 96-105, 223-25.

such groups as organized labor and declining industries have succeeded in influencing the direction of these policies. The wellspring of this regulation, however, would appear to be an emotional, neopopulist, anti-business movement that arose in the United States in an era when the U.S. economy was growing much more rapidly. As growth has slowed, the regulatory games that Leone describes have impinged more noticeably on our standard of living.

Leone's project is more modest. He weaves a series of "stories" about individual regulatory episodes into a set of lessons for decision-makers. These anecdotes are drawn preponderantly from water pollution¹⁹ and automobile regulation,²⁰ two areas in which Leone has a great deal of experience as both a scholar and a technocrat. Given his background, one might have expected that his methodology would be to suggest approaches that would mitigate the damage created by the regulatory game. However, his approach is *descriptive*: Leone utilizes these episodic examples as illustrations of the government's effect upon the cost structure of firms,²¹ the level of industry capacity,²² and the level of final demand for an industry's product.²³

After giving us his insights on how government matters in a competitive environment, Leone then turns to a set of lectures for businessmen and public policy managers. Businesses are given insights into how they might use government's interventions for their own advantage.²⁴ Public policy managers are given "guidelines for action" that allow them to navigate the shoals of enlightened self-interest of businessmen.²⁵ Both sides are warned against naive responses to the other, and are cautioned to consider the long-run implications of their answers.

II. A Technical Critique

Most of Leone's analysis in the first section of the book is straightforward applied microeconomics with which this reviewer is in agreement. One can quibble with some of the cases—for example, his discussion of airbags for automobiles.²⁶ He concludes that automobile producers have

19. *E.g.*, pp. 194-96 (discussing how producers might deal with the "creeping incrementalism" of Environmental Protection Agency water pollution standards).

20. *E.g.*, pp. 65-66 (discussing potential impact of passive restraint rules on variability of costs in auto industry).

21. *E.g.*, pp. 55-57 (water pollution regulation raises fixed costs of paper industry).

22. *E.g.*, pp. 72-78 (impact of regulation-created retrofit costs on capacity).

23. *E.g.*, pp. 92-94 (regulation as factor influencing firms' product line decisions).

24. *E.g.*, p. 166 (businessmen should "look for ways to use government regulation as a competitive weapon").

25. *E.g.*, p.188 (government managers should take steps to avoid "methodological capture" of agency decision-making by both business and government colleagues).

26. Pp. 68-69.

fought the requirement for airbags because such a policy would have reduced the demand for new automobiles even though it would reduce the net private cost of vehicle ownership.²⁷ Why would a lower net cost of owning and operating a *new* vehicle (as opposed to continued use of an older non-airbag car) lead to *lower* demand for new cars?

Elsewhere, Leone's discussion of the Big Three automobile producers' response to mandated fuel economy standards is unsatisfying. Ford's strategy to downsize compact and intermediate classes of automobiles²⁸ failed because Ford seemed to be unwilling or unable to move new designs in the market immediately after 1977-1978. A change in management in the 1980's seems to have been responsible for the recent rejuvenation of Ford, a fact Leone neglects altogether. And his discussion of Chrysler's strategy²⁹ also suffers from his failure to follow through to the 1980's, for by 1985 Chrysler was the only major producer apparently in favor of continuing the government's mandated Corporate Average Fuel Economy (CAFE) standards. Ford and General Motors, though, did not come out against CAFE despite their difficulties in meeting the standards in 1983-1985. Why? Perhaps their concern was a tactical one—a Michigan Congressman was the author of the original legislation, and the vehicle companies could not risk offending him. Moreover, CAFE is more of a problem for European producers of expensive cars than for U.S. producers. It therefore acts as an informal trade barrier.

Leone's discussion of the different Big Three automobile company positions on the import quotas on automobiles from Japan³⁰ is more persuasive. General Motors was not disposed to support this policy because it would encourage the Japanese to upgrade their import mix and therefore compete directly with General Motors' mix. He also points out that the quotas accelerated the pace of Japanese direct investment in U.S. productive capacity,³¹ but fails to tell us why this investment is more adverse to General Motors than to other U.S. producers.

This first section of the book should convince the lay reader that government can and does affect market competition. The professional economist will not be startled by this conclusion. The scholar searching for new estimates of how much private interests gain from regulation, however, will be disappointed. Leone has not added to our knowledge of the direct and indirect costs or benefits of regulation, nor of the rents appropriated by labor, capital, or management. He has only shown the lay reader that

27. P. 69.

28. Discussed at pp. 101-02.

29. Pp. 103-04.

30. Pp. 105-09.

31. P. 106.

these rents are available. Nor has he offered new insights into the economic effects of regulation. It would have been interesting to get Leone's prescriptions for improving regulatory policy, but he does not offer us this public policy insight.

As a stylistic matter, Leone's book is readable and clearly organized. However, its style is obviously for the lay reader, not for the professional.

III. A More Fundamental Objection

It is with the last part of the book that this reviewer has the greatest difficulty. First, Leone advises businessmen to recognize the effects of regulation on competition and to adapt and even shape these regulatory policies for their own profit. The private strategies for dealing with government border on the obvious. Do not attempt the blustering approach.³² Rather, plan to use and lobby for government policies in a manner consistent with your own self-interest.³³ Leone uses material from a Harvard Business School case study on a petroleum refinery built during this country's regulatory madness towards oil prices and imports.³⁴ He concludes from this exercise that a firm can cope with and profit from even this absurd form of regulation.³⁵ This conclusion raises two questions. First, the reader might ask if he should be reassured or appalled by it. Second, if any given regulation profits someone, what is Leone's standard for distinguishing welfare-enhancing regulation from wasteful regulation? Furthermore, if the firm Leone discusses has profited from the regulation in question, doesn't Leone's own Iron Law demand that some firm he has omitted from his discussion has lost? Does Leone mean to suggest that he believes any given firm can "win" at any time, or that in the long run each firm will have its turn as a winner? Moreover, are there no other players besides businesses and government in this game?

Leone, the technocrat, then advises his successors in government to eschew technocracy and to pursue an avowedly political strategy of promoting the public welfare by recognizing that businessmen will try to influence policy and at least adapt to it.³⁶ But what is the policymaker's goal—his "objective function" in the parlance of theory?

These dual prescriptions leave this reviewer a bit puzzled. What is Leone's implicit model of this regulatory game? If Player A (the businessman) recognizes that Player B (the policymaker/technocrat) will adapt to

32. The "naive response" to regulation and its characteristics are described by Leone at pp. 134-45.

33. This is the essence of the "sophisticated approach" described at pp. 159-75.

34. Pp. 146-58.

35. Pp. 157-58.

36. Pp. 176-97.

his response, will A not adjust to B's "reaction function"? And won't B then react to A's reaction function? What are the equilibrium properties of this game? Of course, without a coherent theoretical model or policy agenda, there is no reason to expect any equilibrium. Still, one wonders whether there are organizational factors that would make it easier for one side to adjust more rapidly than the other. Are there more constraints on corporate decision-making and discretion than on its bureaucratic opposite? Certainly corporate decision-makers have more discretion in many areas. On the other hand, they may be in some instances more personally accountable for the results of their choices than bureaucrats; they may be more likely to bear the costs as well as the benefits of their professional strategies. Unfortunately, Leone does not compare the bureaucratic hierarchy to the corporate, except to note that bureaucratic decisions are made in a "bottom up" authority hierarchy, while corporate decisions are "top down."³⁷ But what implications does this discrepancy have for the strategies Leone offers? Again, it would be problematic if *both* sides tried to adjust simultaneously to this discrepancy, once again creating the disequilibrium dynamic described above.

Leone leaves us with the uncomfortable feeling that he thinks everyone can "win."³⁸ As long as the businessman recognizes the game, he can adapt and even influence the regulatory outcome. But doesn't he always win at the expense of some other businessman? In short, Leone never tells us what happens if *all* competitors and policymakers read this book. As a matter of logic, Leone's book would have been most valuable not only if he had offered tips to one side only—to business, probably—but also if he had printed only one copy, and sold it to *one* businessman.

The reader might wish to contrast this book with Schultze's *The Public Use of Private Interest*³⁹ or White's *Reforming Regulation*.⁴⁰ Schultze's book suggests how policymakers can harness private incentives to achieve social goals. White's book gives us a wealth of well-documented examples of how regulatory decisions are actually made. Schultze offers the solution for a number of the real-world follies of government that White uncovers.

Both Schultze's and White's books are extremely useful for the public-spirited policymaker. It is unclear whether Leone's real audience is the public-spirited policymaker, the public-spirited businessman, or the private-spirited businessman. My impression is that his real topic is the private use of the public interest, the concern of Public Choice literature.

37. Pp. 123-25.

38. Leone advises the astute industrialist, when faced with government regulation, to "be a winner." This is part of Leone's "sophisticated response."

39. C. SCHULTZE, *THE PUBLIC USE OF PRIVATE INTEREST* (1977).

40. L. WHITE, *REFORMING REGULATION: PROCESSES AND PROBLEMS* (1981).

He must then confront that branch of the literature with decidedly unpleasant implications: the theory of rent-seeking behavior. Only by combining the lessons of Schultze and White with the insights of the Public Choice literature could Leone offer the reader a "regulatory game" that would truly be worth the candle.