

Takeaways from the Prisms

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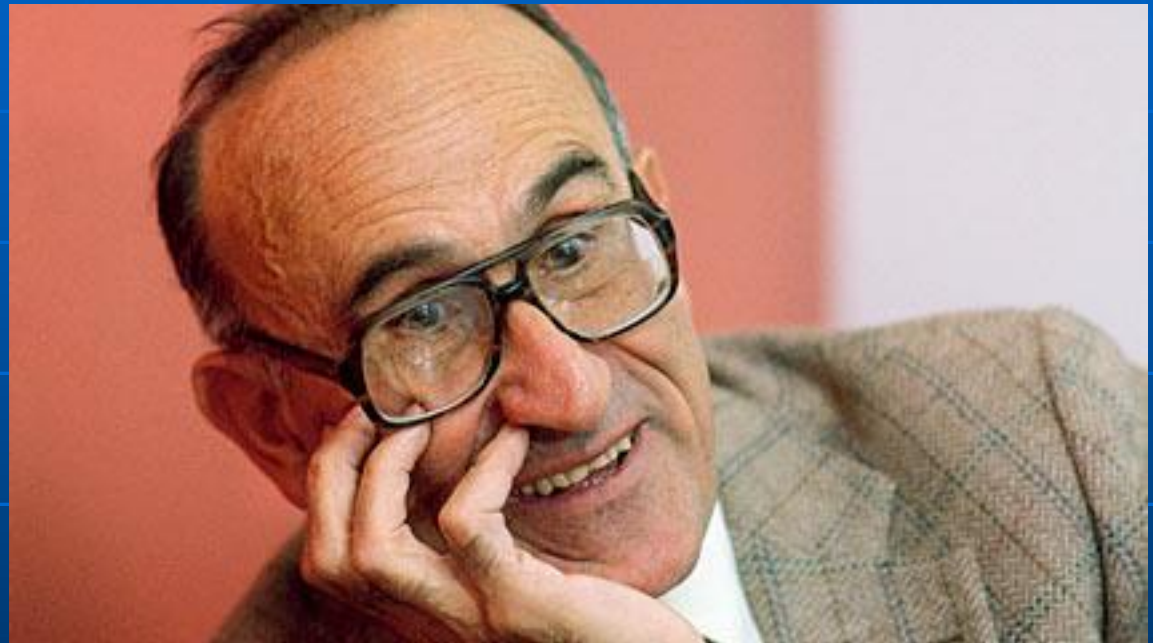
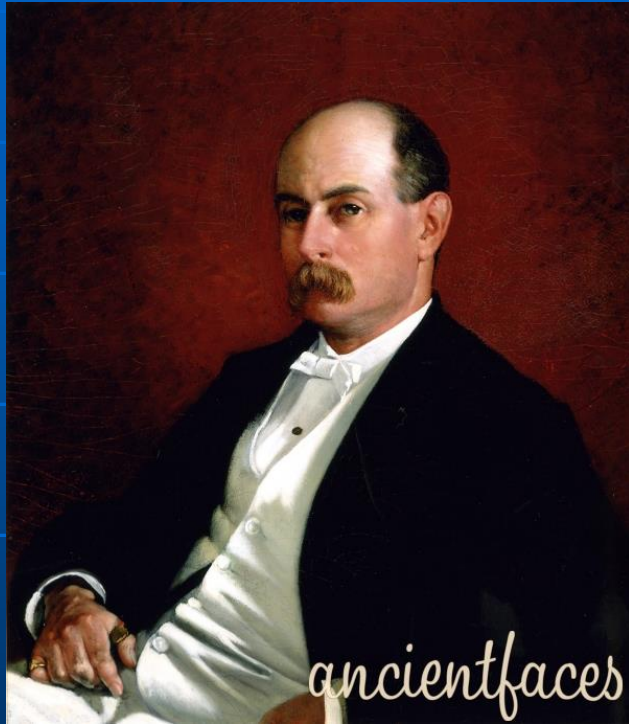
How is regulation legitimate?

- Rigorous economic analysis makes it legitimate
- Provides normative content for public interest regulation
- Good economic regulation benefits: the public, the regulated businesses, capital markets
- Rebutts the:
 - Public Choice critique of regulation (capture, taxation by regulation)
 - Regulatory whim
 - BUT NOT the Free Culture view of economics

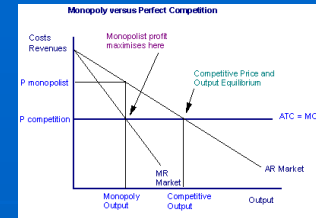
The Five Prisms

- **Neoclassical Economics**
- **Schumpeterian Dynamism**
- **New Institutional Economics**
- **Public Choice Theory**
- **Code As Law -- Postmodern
Non-Economics**

Adams and Kahn



Neoclassical Economics



- Deductive, formalized theory for regulation
- The core theoretical basis for economic regulation
- Explains imperative for above-MC pricing
- Explains imperative for price discrimination
- Can give a false sense of “science” and mathematical precision to enterprise (when tail-chasing is the reality)
- Blackboard economics
- Static, not a dynamic, model



Schumpeter

Dynamic -- not static efficiency of the neoclassicist -- is what matters in a capitalist economy

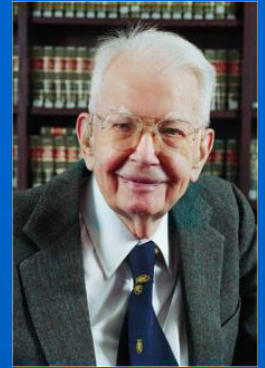
Competition *for* the market is more important than competition *in* the market

Capitalism is a process of creative destruction

Regulatory institutions' tools poorly accommodate dynamic market conditions

Regulatory institutions should seek to create incentives for regulated entities to innovate – and internalize rents from innovation

New Institutional Economics



Institutions Matter

Operating assumptions: bounded rationality, information asymmetries, opportunism

Method is inductive – reasons up from observed behavior

Unclear property rules create incentives to rentseek and increase transaction costs

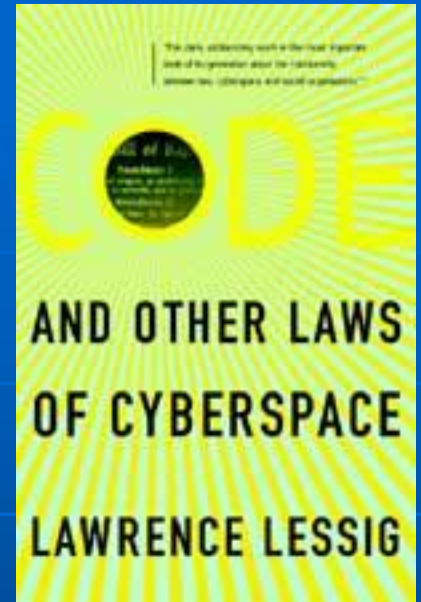
Design institutions to: reduce rentseeking, acknowledge cognitive boundaries, elicit information, reduce opportunism

Public Choice Theory

- **Regulatory capture and taxation by regulation is real, documented and inevitable**
 - **When public choice hazards high, market imperfections might be preferred**
- **Create institutional arrangement to minimize public choice hazards. For instance, if every rule or right is a 'jump ball', then rentseeking will increase.**
- **Political compromises needed to enact reform can give the worst of both worlds – bad regulation and bad markets.**
 - **E.g., electric restructuring in MD and CA**
 - **Corruption has an efficiency rationale**

Code is Law

- **Economics does not encompass all social values**
- **Public control over constitutive decision is appropriate and just**
- **Normative value of freedom should override efficiency**



Final Reflections (or bromides)

- Modesty toward what you know and don't know should be kept in forefront
- Integrity and character matter – speaking truth to power, with rigor and reason, make regulation better
- Regulation is comparative, not binary, with markets
- Schrodinger's Cat dilemma is real for regulators

I'll see you on the Dark Side of the Moon

