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# The Justifications for the Regulation

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**Abstract:** The classical economists have mostly focused their attention on the functioning of the market and not on the role of the state. The analyses of various democracies are based on the assumption that the State decisions once made are applied as intended by the authorities who are responsible for their practical implementation. The economics of regulation is situated at the intersection of the public economics and industrial economics, it explores different forms of government intervention in industrial activities to simulate either to control or even to reprove them. Public intervention can take different forms: in Europe the most common practice is the nationalization, it is the public monopoly of law. In the United States operation of this natural monopoly is assured through economic regulation, that is to say all means by which Governments directly influence the activity of companies while maintaining the framework of the private property. It is very important to distinguish between the economic regulation of an activity that focuses on the price and the determination of the structure of offer, and the social regulation concerning the conditions for the exercise in the activity and the physical characteristics of the products or services (protection of workers in their working conditions (health, security), rules of environmental protection or standardization of products (quality).

**Keywords:** Market, lobby, regulation, optimum, rent seeking, Government.

## INTRODUCTION

The justification of the public interest in violation of individual preferences can be incorporated into a normative individualist approach to the public economy according to two lines of argument: either by problems of distortion of preferences or a character of external effects.

### Problems of preferences distortion

Some economists as Bergson and Musgrave admit that other reasons than those associated with market failures warrant normative recommendations, which although based on individual values, diverge from individual preferences. For this, they make a distinction between preferences, satisfaction and well-being.

According to Head [1], individual welfare must be the basis of allocation norms and not the preferences actually revealed on the market. The preferences may indeed be distorted by two types of influence:

Individual preferences for a large number of goods are the result of a certain ignorance or incomplete information; in this case, public intervention by means of fiscal measures or regulations aimed at correcting for example tendentious information should make it possible to produce choices that individuals themselves would be able to recognize as superior.

There are differences between an individual's preferences and well-being following the irrationality of choices. Intervention justified by irrationality can be reconciled with the normative model when consumers voluntarily give up their sovereignty to certain types of choice (foreign policy, for example), but here the correction of the preferences judged by certain irrationals implies a tendency to authoritarianism that can hardly be reconciled with a normative model based on consumer sovereignty.

### Externality of good under tutorship

Goods under tutorship can be explained by the presence of important external effects (eg, drugs). For Mac Lure, these are internalized externalities and it is not necessary to use a new term to designate the compensation or intervention system operated by the public authorities to ensure the optimal allocation of resources in the event of externalities.

According to Benard regulations mainly concerned two forms of market and firms: increasing

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returns sector and natural monopoly and those non-increasing returns where distributional concerns (social) cause protectionist regulations.

According to Pondaven regulations can be analyzed in terms of three paradigms: economic efficiency, equity, political efficacy.

**Regulation and equity**

Remember that the Pareto optimum is defined for a given distribution revenues, for each distribution of wealth correspond an economic optimum, and the state may intervene to redistribute wealth according to its conception of equity.

Income redistribution can be studied from two different angles

- In terms of regulation undertaken to satisfy a condition of fairness.
- In terms of taxation to define the optimal sharing rules (tax burden).

We see that the first appearance here the fair regulations, i.e., equitable is one that satisfies certain arbitration rules between consumer interests and the interests of producers subject to the conditions of taxation, the properties of such rules have been defined by [2].

A regulation arbitrating fairly between the respective interests of consumers and producers checks three properties:

- It is favorable to both consumers and producers of the regulated good.
- It implies the absence of liquid transfer from consumers to producers.
- The tutor is fair i.e. equitable in pricing.

Conditions for equitable arbitration are provided by the tutor arbitrator. Regulation must be seen as a process of exchange relating producers and consumers and incorporating the State as referee;

Fair regulation is not necessarily egalitarian, equitable justice is simply a profitable justice to all without condition on gain sharing, between all, some may earn more than others, but each group of agents necessarily takes a interest in, regulation just:

- Producers get permission to maintain their cartel; in exchange they give price benefits to consumer, however prices remain higher than those of competitors.
- Thus Consumers are beyond to the cartel prices, and draw an advantage.

Regulated prices which are acceptable for both groups of agents of contradictory interests are included in the profitable prices of cartel producers and satisfactory price competition for consumers.

Lee's solution determines the fair price defined as the price which ensures a distribution of wealth and a fair allocation of resources.

The suitable regulation involves preferential prices (or social preferential price), these prices have the advantage of keep unchanged respectively consumer and producer surplus, these two prices are called first price and second price determine the boundaries of lower price upper and imposed by the referee ,

To ensure that the regulation benefits to producers and consumers, it must establish an intermediate price between those two.

**Regulation and policy effectiveness**

Normative theory of social welfare based on the paradigm of Paretian economic efficiency, leaves no chance, to pressure groups which play a crucial role in the implementation of the management and elimination of economic regulations.

That's why appears the literature using the theory of public choice in the behavior of men and Governments.
The ability to attract government regulations, encourage some people to be in lobbies seeking for approaches rents, and participate in the refutation of the regulations.
Away from concern for the collective interest, regulation involved in rent seeking strategies that favor some at the expense of others and all; public choice theorists have initiated Stigler's approach regulation based on the logic of political bargaining between the government and a majority of reduced size winners .The conditions of success of such negotiations are formalized by Peltzman giving in his model [3]. This model is rooted in capture theory [4].

Stigler extends the works of Tullock [5], who argued that firms are willing to devote significant resources to bring those responsible for decisions to adopt rules ensuring their protection. The initial findings of Stigler remain fairly pessimistic about the role of regulation as correcting market failures.

The Misallocation of resources due to attempts to create situation rents can have worse effects than those who come from the monopoly power or other market failures which could justify the introduction of a regulation.

According to Stigler : we have mainly use regulations to protect firms which are already on the market entry of potential competitors: Politicians can vote a regulation approach not to meet an abstract public interest, but to benefit from the potential political impact of the operation. Interest groups who have the most chance to gain from regulation are those who are willing to invest more resources to get the support of politicians, so the regulated firms are often able to obtain the regulation which complies with their wishes.

The originality of Stigler's analysis is to bring regulation to a problem of bargaining between the tutor offeror of services and citizen guarantees of political support in exchange for protections acquired; the regulation is therefore reduced to finding an optimal size of favorable votes.

For ensuring a sufficient political support, the tutor must guarantee to its supporters payment transfers; transfers verify a diminishing returns depending on the size of the beneficiary group.

The costs of running campaigns of political support not only limit the size of the dominant group but also their gains ; and the low number of winners helps to facilitate consistency of their requirements and negotiations with the tutor, So it is the low number of winners who is important than their electoral weight.

This theory is called a theory of capture or predation, as soon as regulated agents are able to turn to their advantage to regulation during successive bargaining with the tutor. The number of partners and their influence are crucial and determine the sharing winner's losers; the number of winners should not be too high for the gain per head and will be sufficient to ensure their political support.

On the other hand, the number of victims (losers) should be high in order to effectively disseminate the per capita cost of regulations.

The first objective of the regulation according to the theory of predation is not the search for an optimum, but to obtain monopolies satisfactory efficiency without abandoning too high rents to the various partners.

The necessary and sufficient conditions for the optimal size of the group winners are presented by Peltzman.

According to the Peltzman model, "optimum political support formalizes the economic theory of regulation of particular interest, and all the operating costs of the campaigns of support slow down the size of the group dominating but imposing also a maximum threshold for the distribution of transfers".

The particular interest of the tutor is represented by its authority to control and tax the votes of citizens; a favorable voter receives a subsidy, the opposition members are penalized by a tax to finance the transfer allocated to the winners, the search of political support is equivalent to setting the optimal political majority.

This model is a negative sum game even though transfers to winners are fully financed by taxes levied on the losers. Regulation deviates from the Paretian solution and thus generates a deadweight loss. Regulated prices are indeed different from optimal competitive prices and adversely affect economic efficiency, that's why we can say the game is to sum zero.

Expenditure persuasion can help the tutor to reduce the opponents by taxing different losers differently, thus the opposition can be reduced; Perlzman defines the conditions for minimizing the opposition by distinguishing two groups of losers.

The view of Stigler was supported by Peltzman [6], according to him: railways were regulated under the pressure of railway companies themselves.

The simplest theory developed by Posner, who gets the theme of regulatory capture by lobbies.
Peltzman precise this thesis by analyzing the differences between optimal and actual regulation depending on the nature of the political support received by the government.

Peltzman's model [6] considers regulation which aims pricing to improve the economic situation of a particular group (beneficiaries) to the detriment of the rest of the population. Transfer received by beneficiaries is paid by a premium price (relative to competitive levels) or a tax on the victims. Beneficiaries will often be producers and victims will be consumers (final or intermediate).

It does not mean a zero-sum game, since any price distortion compared to the competitive equilibrium leads to social efficiency loss, so it is a negative sum game.

Beneficiaries and the victims are the citizens whose authority seeks to maximize their maximum votes, since in democratic regime its survival depends on them. Thus the government will therefore determine its regulatory policy to attract maximum favorable votes of voice beneficiaries or part of victims of this policy.

The main result is to show that difficulty into vote's transfers representing advantage for beneficiaries and taxes for the victims led authorities to concentrate benefits on a small number of beneficiaries.

The same reason leads symmetrically to disseminate losses represented for example by taxes on a large number of victims and the beneficiaries will be more keenly aware of their advantages and victims bear their losses more painless.

This economic reasoning reinforces the sociological observations that show a very small count protest beneficiaries are eloquent and well organized support the weight of their benefits to a large number of silent and unorganized victims.

## CONCLUSION

The substitution of economic criteria by political criteria in process of setting prices explains the permanent tendency of regulation to encourage cross-subsidies in the form of equalization of prices where consumers facing high costs are subsidized by those low cost whose income is thus redistributed.

This incentive to tax or to subsidize all consumers because of the special characteristics of some has consequences on the structure of regulated prices. This system is antithetical to the profit maximization since it subsidize unprofitable activities (or consumption of high cost) more profitable activities (or consumption of low cost). These phenomena are explained by political and sociological pressures but also on the model of Peltzman.

Maintaining constant demand, consumption to high cost will receive price/consumption reports below. Their high costs will be distributed among all consumers by a rational policy to maximize political support.

The interventions of lobbies in establishing a price or quantitative regulation manifested by political pressures but also supplies economic information to defend their case and persuade the tutor for their favor.

The idea is that the market does not fully satisfactory manner especially in connection with the structure of the sector and is not with the nature of the goods.

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