Federalism & Separation of Powers

Controlling the "Fourth Branch": The Fight Against Agency Capture May be a Losing Battle

*by C. Boyden Gray**

Separation-of-powers issues will always confront politicians, judges and policymakers because the principle of the separation of powers is so central to the constitutional design: each branch will forever be poaching on another branch's turf, as illustrated by the Senate Democrats' recent bold assertion that a President needs sixty votes to confirm a judicial nominee if any Senator so decrees. The most difficult inter-branch problem, however, is much less glamorous and thus much more difficult to resolve—and that involves oversight and control over the so-called "Fourth Branch" of government[1]—the "administrative state" made up of the many regulatory agencies with alphabet titles like EPA, FDA, FCC and SEC.

The Fourth Branch Checked: Previous Reform Efforts Rolled Back "Agency Capture"

There is not the space here to go into the history of these agencies, the companion regime of antitrust law or the development of the Administrative Procedure Act of the late l940's, which governs much of the relationship of these agencies to the Congress, the White House and, most importantly, the courts. Suffice it to say that much of the initial impetus for agency regulation came from the regulated community itself, as distinguished from consumer groups or the public, and this legacy has significantly influenced the behavior of the regulatory community ever since.

In part as a result of the special interest parentage, the regulatory agencies—part legislature, part enforcement and part judiciary—were never established to be directly accountable to any one of the Three Branches of Government. Instead, they were designed to be self-contained mini-governments of their own, responsive primarily to the communities they regulate. These agencies were thus not directly accountable to the voter and, not surprisingly, went increasingly out of control.

For example, the impetus for the typical state "PUC"—*i.e.*, the electrical utility or telephone rate-setting body often called a Public Utility Commission—came from the electrical utilities themselves seeking protection from what they perceived to be ruinous competition. The same dynamic explains the ICC and the CAB, and even some of the original support for the antitrust laws, as some companies sought protection from competition that benefited consumers and the public generally.

The phenomenon of agencies responding more to the special interests they were supposed to regulate than to the public has been called the problem of "agency capture." Over time, this misuse of government authority by private interests—sometimes also referred to by economists as "rent seeking"—has been pared back: we no longer have an ICC or a CAB, and the courts have now for many decades interpreted the antitrust laws to protect consumers, not competitors, as the courts had originally viewed these laws in the very early part of last century.

The principal theory of the reform movement was that pure economic and price regulation served virtually no public purpose and should be eliminated. Health and safety regulation survived, of course. But the reformers generally succeeded in limiting the agencies to setting the end goals rather than prescribing the means of compliance (*i.e.*, setting "performance standards"), so that the regulated interests could not manipulate the agencies for their own benefit or to eliminate competition.

It is important to note here that the regulatory reform movement reached its high point in the late 70's and early 80's under Presidents Ford, Carter and Reagan (and generally Democratic Congresses) and was broadly bipartisan. A key leadership role was played by Senator Edward Kennedy on transportation deregulation, aided and abetted by his then chief counsel, Harvard Law Professor—now Justice—Steve Breyer.[2] And the reform movement engaged all three branches. It was the Congress, of course, that eliminated the ICC and the CAB; its other initiative—the legislative veto—represented an effort to look like it was reining in the agencies without actually having to do any heavy lifting and was blessedly struck down by the Supreme Court.[3] For their part, the courts, especially the D.C. Circuit and the Supreme Court, also grappled repeatedly with agency oversight. Finally, the White House entered the fray, especially in the early Reagan years, to make sure that agencies' regulations preserved competition to the extent possible.[4]

An argument could be made that the result made a significant contribution to the great economic expansion that began in l982 under Reagan and continued for nearly two decades until the high-tech bubble burst in 2000. Certainly most experts attribute the significant difference in GDP growth between the United States and Europe to the much more deregulatory climate that prevails in the former than in the latter. The question to be addressed in the remainder of this essay is whether these past gains are endangered by any recent developments. Two developments will be discussed—the effort to create greater harmonization with Europe and the emergence of "regulation by litigation" spawned by the trial lawyers. Both de-

velopments, it will be seen, are heavily influenced by special economic interests involved in rent seeking that endangers the gains of the last two decades.

The Fourth Branch's New Strength: the European Union and Trial Lawyers

Although it is too early to be definitive, there are warning signs that Europe may be trying to export its less transparent and flexible regulatory system to the United States in order, perhaps, to reduce the U.S. competitive advantage. The European regulatory system differs from the U.S. system in many respects—but the two most important differences are (1) the extent to which Europe delegates the initial development of regulations to the regulated industry itself in a manner that is not very transparent and that invites rent seeking and "capture" and (2) the general lack of judicial review of regulations. The lack of review, of course, reinforces the lack of transparency as well as the rent seeking. Put another way, the European regulatory approach—influenced as it is by special interests—currently behaves a lot like the U.S. system before the reforms of two decades ago.

Probably the most celebrated example of Europe's approach is its rejection of genetically modified foods (so called "GM" products) in the admitted (by Europe's own technical experts) absence of any human health risk.[5] This rejection has now been exported to Africa, which is experiencing difficulty with its agricultural production and could benefit from technological assistance.[6] One cannot avoid the suspicion that Europe's (especially France's) heavily subsidized farmers are using the regulatory framework to disarm legitimate competition both at home and abroad, to the disadvantage principally of Africa's farmers and consumers and secondarily of American farmers.

The problem extends further, however. In addition to persuading African farmers not to use cost-cutting and productivity-enhancing technology, Europe is also dumping excess food production on Africa through the use of massive export subsidies, which in turn are gravely threatening the Doha Round of trade talks, and thus threatening the free trade system itself. It all has its origins in the capture of government operations by private interests—here farming interests—and then the distortions cascade down the line. This is forcing the U.S. farmer to respond in kind and this, in turn, is beginning to reintroduce the kind of competition-chilling regulatory abuses that the reform movement eliminated two decades ago.

It would be far better for Europe to embrace the new technology and then use it, with the financial help of export subsidies redirected to something productive, to support development of liquid fuel alternatives to crude oil, thus competing with the Saudis rather than the impoverished African farmer. But suspicion of biotechnology extends to new drug development as well. Both Europe and Canada take advantage of the creativity of our highly productive drug companies by slapping their price controls on our drugs and putting all the burden of research on the American consumer. This cannot last forever, because Europe and Canada may succeed in exporting their price controls to us through reimportation, thus eventually killing the goose that has been laying hundreds of golden eggs.

The second example is the mass tort lawsuit perfected by the trial lawyers. Some of these lawyers are quite candid in admitting that they are engaging in "regulation by litigation" to achieve the results that the principles of regulatory reform have denied them both in the regulatory agencies themselves and in Congress. Needless to say, this is not what the Founders had in mind for the judicial system. One illustration is what litigation is doing to the delivery of health care. Tort litigation has so driven up the cost of insurance in some states that some doctors are moving out.[7] In other states, tort suits are disrupting the delivery of drugs to patients and impeding the approval of new therapies.

Thus, the FDA began speeding the approval of AIDS drugs in the late 1980's on the condition that patient groups and drug companies provide adverse side-effect results in a timely and comprehensive fashion so that the FDA could be informed of side effects that might have been missed during the truncated drug approval process. This experiment worked well enough that in 1997 Congress extended the promise of expedited drug approval procedures at FDA, in return for post-approval studies, to all serious and life-threatening diseases.[8] Post-approval studies have, however, not been completed as promptly and thoroughly as expected, which has delayed the speed-up in drug approval. The reason is that prompt post-approval studies can be greatly abused by trial lawyers seeking to file massive class action lawsuits, which in turn also discourage patients from taking drugs they should be taking.

In these examples, it is the trial lawyers who have become the rent-seeking special interests, but the damage is no less than if one competitor captured the power of government to the disadvantage of another. In the other case, it is Europe—or a foreign sovereign power—that is influencing our regulatory agencies at the indirect behest of their vested interests. Could these entities equally and directly influence the Congress itself, which initially delegated the original authority to the regulatory agencies, or the White House, which is responsible for the execution of the delegated law? The answer is that it would be doubtful that U.S. trading partners or trial lawyers could capture the Congress or the White House, which have to face periodic reelection. But what reform measures will now work to make these agencies more responsive to the U.S. voter and less responsive to the trial lawyer or the European farm bureaucrat is not yet clear.

The Fourth Branch's Future: Reform Must Come from the Other Three Branches

As was the case with regulatory reform in the l970's and 80's, the reform will have to be imposed on the agencies by one or more of the original three branches—*i.e.*, the federal judiciary, the Congress or the White House, or some combination. For example, the actions of trading partners can be influenced most directly by the White House through the Trade Representative's Office, with Congress also possibly playing a key role. There is not much, by contrast, that the Judiciary can do in the first instance. With respect to mass tort "regulation by litigation," Congress probably has to play the lead role—both to provide for easier removal of the mass tort action at the state level to federal court and to provide for preemption of state tort law where interference is most complete between the tort action and the regulatory regime. The courts will be directly involved, obviously, to rule on implied preemption requests that, in turn, the White House might seek in the absence of explicit congressional direction.

The question, though, is to what extent the trial lawyers and the diplomats can divert the three branches' attention away from the need to regain control of the Fourth Branch of Government from today's special interests. This question really is no different from the question posed more than two decades ago—whether there was political will to regain control of the agencies from the "capture" of these agencies by the then-dominant regulated special interests. The counterattack by reformers to restore accountability to the Three Branches and the public has begun—with the USTR fighting both Europe's retention of export subsidies and its opposition to GM foods,[9] and both the White House and Congress opposing the trial lawyers.[10] But the outcome, at this writing, is still in doubt.

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Footnotes

[1] *See also, e.g.*, C. Boyden Gray, *The Search for an Intelligible Principle: Cost-Benefit Analysis and the Nondelegation Doctrine*, 5 Tex. Rev. L. & Pol. 1, 2 (2000); *cf.* Freytag v. Comm'r of Internal Revenue, 501 U.S. 868, 921 (1991) (Scalia, J., concurring in part and concurring in the judgment).

[2] Senator Kennedy spearheaded transportation deregulation in the U.S. Senate by chairing hearings on deregulating the airlines in 1976. *See Oversight of Civil Aeronautics Board Practices and Procedures: Hearings Before the Subcomm. on Admin. Practice & Procedure of the Senate Comm. on the Judiciary*, 94th Cong., 1st Sess. 3 (1975); *see also* Brent L. Hoffman, *Justice Stephen G. Breyer, Business Friend and Environmental Foe?: An Analysis of Justice Breyer's Judicial & Non-Judicial Works Concerning Environmental Regulation*, 100 Dick. L. Rev. 211, 212-13 (1995) (discussing then-Professor Breyer's work on transportation deregulation).

[3] *See* INS v. Chadha, 462 U.S. 919 (1983) (striking down Section 244(c)2 of the INS Act).

[4] *See, e.g.*, Exec. Order No. 12,291 (1981) (requiring that federal agencies conduct a Regulatory Impact Analysis (RIA) of proposed major regulations, including *inter alia* their affect on competition).

[5] For a collection of the European Union's directives and guidelines regulating "genetically modified organisms," see http://www.eurunion.org/legislat/Foodstuffs/NovelFoods.htm (last visited Dec. 28, 2003). The European Union's regulations are supported not by known health risks but instead by the "precautionary principle," or the possibility that some human health risk may be revealed in the future. *See, e.g.*, Karen Lowry Miller, *The Battle Over Caution; A Brussels Philosophy Antagonizes the United States and Others*, Newsweek, Dec. 15, 2003, at 38; *see also Compulsory Labeling of Food Produced from Genetically Modified Soya Beans and Maize*, 4 Colum. J. Eur. L. 179, 181 (1998) (stating that the European Commission caved to pressure to devise GM labeling scheme after it determined that GM maize presented *no risk* and initially decided to permit community-wide marketing of the maize).

[6] *See, e.g.*, Robert L. Paarlberg, *African Famine, Made in Europe*, Wall St. J., Aug. 23, 2002, at A12; Press Release, State Department, Evans Addresses Third AGOA Forum (Dec. 10, 2003), *available at* 2003 WL 64739413.

[7] *See, e.g.*, Judith VandeWater, *Soaring Malpractice Insurance Has Doctors Retiring, Relocating; Losing Neurosurgeons Could Cost Patient Lives, Experts Say*, St. Louis Post-Dispatch, Sept. 22, 2003, at A1, *available at* 2003 WL 3610282.

[8] FDA Modernization Act of 1997, Pub. L. No. 105-115, 111 Stat. 2296 (1997).

[9] *See, e.g.*, *U.S., EU Fail to Settle Dispute Over Biotech; Washington Going to Trade Panel; Canada Likely to Join Challenge*, Toronto Star, June 20, 2003, at D6, *available at* 2003 WL 57342520; Press Release, State Department, Zoellick: Wide Range of Expertise Represented at AGOA Forum—Says it's Now Time to "Get Down to Work" to Solve Africa's Problems (Jan. 16, 2003), *available at* 2003 WL 2045670.

[10] *See* President George W. Bush, *Statement on Class Action Fairness Act*, White House, *at* http://www.whitehouse.gov/news/releases/2003/10/20031023-2.html (Oct. 23, 2003); Press Release, White House, Remarks by the President to the Greater Manchester Chamber of Commerce (Oct. 9, 2003), *available at* 2003 WL 7518272.