

Business Ethics, Democratic Theory, and the Regulatory State: *Merriment & Diversion when Regulators and the Regulated Meet?*

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Comments and critiques always welcome.*

Note for the HBS Normative Ethics & Welfare Economics Conference: This paper is about a cluster of normative issues arising for businesses, markets, bureaucrats, politicians, and citizens in the regulatory state. The argument here is addressed most directly to *normative democratic theorists* who have largely ignored these issues, despite the existence of a wealth of relevant empirical research. The paper devotes less space for the discussion of ethical or “beyond-compliance” norms for responsible business engagement with regulatory processes – but this will be played up more in my presentation. For those interested, I am also uploading for the conference participants a recent encyclopedia entry I have written on “Business Ethics,” which: lays out my view on the central topics for this interdisciplinary field; surveys the actual debates around these topics; and makes a case for what I believe are the most promising approaches for future research. I have **highlighted in yellow** a number of passages that could serve as a quick briefing on the wonderful world of academic business ethics. WN

Abstract:

With a few obvious caveats, we all recognize that it is unethical for businesses to fail to comply, deliberately or negligently, with legitimate laws and regulations. But it is also, surely, unethical in most cases for businesses to work actively to prevent or water down legitimate regulations of their activities – especially when these involve the exploitation of socially inefficient market failures. We look to political philosophy for the normative foundations of a concept of “legitimate regulation,” but find little guidance in the most celebrated contemporary theories of justice or democracy. By clearing away some standard assumptions about the independence of regulators and the markets they regulate (within theories of justice and political economy), and about the centrality of the relationship between citizens and their elected representatives (within democratic theory), we pose a dilemma for a normative theory of business regulation. This dilemma has implications for both government regulators and the businesses they regulate: (a) if these two groups are kept apart, the regulations in an advanced modern economy are likely to be clunky and counterproductive; but (b) if the two groups work too closely together in the process of developing regulation, it is likely to result in what Adam Smith would have called a “conspiracy against the public.” One big lesson is that our agenda for normative democratic theory is enlarged considerably when we return to a more “traditional” framework that sees democracy as a form of government and governance, and not merely a kind of decision-making procedure among equal citizens. Another lesson: there is no technocratic design fix that will ensure a fair and efficient regulatory state unless corporations engage in regulatory reform processes responsibly.

Keywords: corporate political responsibilities, regulation, democratic theory, market justification, cost-benefit analysis

1. Introduction

Some form of *constitutional democracy* and *market economy* are presupposed as core features of the modern state by virtually all contemporary political philosophers. And yet there are obvious tensions between ideals of democracy, on the one hand, and of constitutionalism or the market, on the other. Constitutions famously limit what citizens can legitimately bring about through majoritarian decision-making procedures.¹ And markets, mediated by the price system and constrained by

¹ Jon Elster, “Introduction,” in J. Elster and R. Slagstad (eds), *Constitutionalism and Democracy* (Cambridge: Cambridge University Press, 1988): 1-18; Cass Sunstein, *Designing Democracy: What Constitutions Do* (New York: Oxford University Press, 2001).

bureaucratic regulatory agencies, are best seen as an *alternative* to democratic deliberation and decision-making for the allocation of resources and the distribution of a wide range of goods and services.² In this article we will explore some of the challenges for political philosophers seeking a coherent reconciliation of democracy, constitutionalism, and a regulated market economy among the realistic options for contemporary societies. Our focus will be how normative theories of justice and democracy should cope with two intertwined problems in real-world politics and institutional design: one is the challenge for legislators and administrative agencies to design and enforce fair and effective regulations for markets and market participants; and the other concerns the difficulties for both elected representatives and citizens of providing democratically legitimate oversight of the modern regulatory state, especially when it comes to the regulation of business firms and markets.

It is not a mystery why the citizens of a democratic state are interested in, and often concerned about, the rules and regulations governing business and markets. In almost every modern, developed society, most citizens are also employees of businesses, most of their disposable income is spent buying goods and services from businesses, and most of the wealth of the society is generated through markets involving business firms. Even left-leaning liberal-egalitarian philosophers are inclined to accept the necessity of a market economy of some kind (even if not necessarily a capitalist one) for roughly the reasons outlined by the towering figure in this tradition, John Rawls: markets are justified on the basis of their capacity to establish prices, to facilitate free choices of occupation and consumption, and to efficiently generate wealth.³ It goes without saying that right-leaning political philosophers endorse all of these advantages of, or justifications for, markets; even if they might also favor markets for reasons that would be more controversial among their egalitarian colleagues (say, based on the promotion of certain conceptions of freedom, or on the implications of certain conceptions of property rights).⁴

² See Bryan Caplan, *The Myth of the Rational Voter: Why Democracies Choose Bad Policies* (Princeton: Princeton University Press, 2007): Preface. See the discussion in section 2, below, for the kinds of worries John Rawls articulates for the threats to democracy from economic inequalities generated by capitalist markets. See also Thomas Christiano, "The Uneasy Relationship between Democracy and Capital," *Social Philosophy and Policy* 27, no. 1 (2010): 195-217.

³ See John Rawls, *A Theory of Justice* (revised edition) (Cambridge, MA: Harvard University Press, 1999): chapter 5, especially 237-248. Other recent egalitarian "qualified defenses" of markets for at least a range of goods and services include Elizabeth Anderson, *Value in Ethics and Economics* (Cambridge, MA: Harvard University Press, 1993): especially chapter 7; Debra Satz, *Why Some Things Should Not Be For Sale: The Moral Limits of Markets* (Oxford: Oxford University Press, 2010): especially 63-90. For recent discussions on the "compromises" liberal-egalitarians have to permit in order to accept the efficiency benefits of markets, see Joseph Heath, *Morality, Competition, and the Firm* (Oxford: Oxford University Press, 2014): especially 1-21, 173-204; Wayne Norman, "Rawls on Markets and Corporate Governance," *Business Ethics Quarterly* 25, no. 1 (2015): 29-64; Pierre-Yves Néron, "Rethinking the Very Idea of Egalitarian Markets and Corporations," *Business Ethics Quarterly* 25, no. 1 (2015): 97-128.

⁴ See Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), discussed below. For more recent and philosophically informed defenses of markets in the liberal tradition see John Tomasi, *Free Market Fairness* (Princeton: Princeton University Press, 2012); and Jason Brennan and Peter Jaworski, *Markets Without Limits: Moral Virtues and Commercial Interests* (New York: Routledge, 2016).

There is also an important level of convergence among liberal and libertarian political economists on the left and the right about the need for, and justification of, *government regulation* of business.⁵ The very same economic theories that explain the potential benefits of a market economy also explain why those benefits may turn into costs or harms in markets with so-called “market failures” – e.g., markets in which firms collude, exercise monopoly power, externalize the costs of pollution on unwilling neighbors, or deceive customers who lack adequate information about the product or service they are purchasing; to name but a few of the textbook market failures.⁶ So Rawls, for example, writes that:

A democratic society may choose to rely on prices in view of the advantages of doing so, and then to maintain the background institutions which justice requires. This political decision, as well as the regulation of these surrounding arrangements, can be perfectly reasoned and just (Rawls 1999: 248).

And among the roles for regulation, Rawls includes “preventing the establishment of monopolistic restrictions and barriers to the more desirable positions,”⁷ “instituting the necessary corrections” to prevent “public harms, as when industries sully and erode the natural environment” (237), counteracting information asymmetries, and ensuring the provision of certain genuine public goods (240), and defining and enforcing property rights (244). At the other end of the liberal political spectrum, Rawls’s contemporary Milton Friedman would find nothing in principle to disagree with in such a description of the role of governments in a “free-market” economy. Though usually read as an opponent of government interference in the marketplace, Friedman reminds his readers that, “The existence of a free market does not of course eliminate the need for government. On the contrary, government is essential both as a forum for determining the ‘rules of the game’ and as an umpire to interpret and enforce the rules decided on.”⁸

The formulation, enacting, and enforcing of market regulations has become a very large part of what the modern state and government do. It is controversial what the best measurement of the relative “quantity” of government activities is. But it may in fact be the case in most democratic market societies (including a quasi-confederation such as the European Union) that *most* pieces of legislation enacted by parliaments, *most* executive orders or decrees by Prime Ministers and Presidents, and *most* rules and laws developed each year by bureaucrats in administrative agencies are *primarily concerned with the regulation of business and markets*.⁹ Of course, one

⁵ N. Scott Arnold argues that “the traditional disputes between modern liberals and classical liberals about economic regulation have become significantly attenuated over the past few decades, and the disagreements that remain are relatively narrow. By contrast,” he notes, “differences about noneconomic regulation remain profound.” N. Scott Arnold, *Imposing Values: An Essay on Liberalism and Regulation* (New York: Oxford University Press, 2009): ix-x.

⁶ This is not to suggest that the “taming” of market failures is the *only* legitimate rationale for government regulation of markets, but it is a hugely important one, and it is widely accepted across the political spectrum.

⁷ Rawls, *A Theory of Justice*: 243-4.

⁸ Friedman, *Capitalism and Freedom*: 15.

⁹ On this last point, the authors estimate, conservatively, that between two-thirds and three-quarters of the regulations and executive orders proposed, revised, or announced in the US *Federal Register* in 2015 came from departments in US Federal administrative agencies primarily responsible for

would not notice this by cataloguing the examples of institutions, laws, judicial decisions, and public policies discussed (often in passing) by political philosophers. Here we are much more likely to find a focus on issues involving civil rights, minority rights, public education, health insurance and healthcare (which are state-controlled in most OECD countries), law enforcement and criminal justice, the military, or foreign policy. Of course, these mostly non-market domains are also a large part of what elected officials, judges, and bureaucrats are concerned with. But the regulation of businesses raises a special set of concerns for democrats, or so we will argue.

In sum, our aim here is to suggest (a) that designing and administering of laws and regulations for markets is a substantial and necessary role for modern democratic governments; although (b) it a role that is strangely neglected by contemporary political philosophers, even some of the very few who explicitly deal with the problems of the regulatory state; and (c) that the regulation of business raises some special and difficult challenges for *theorists of democracy*. A strong argument to convince a skeptic of the claims in (a) and (b) would probably require two additional self-standing articles, so we will only attempt here to provide a sketch of the evidence in an attempt to pique the interest of a sympathetic reader. Our primary aim is to highlight (c), some challenges business regulation poses for democracy in the modern state and for *theories* of democracy of the sort that have dominated political philosophy in recent decades.

In an important article on the foundations of democratic theory, Ronald Dworkin illuminates one aspect of the challenge we are exploring in this article.

Democracy requires that officials should be elected by the people rather than chosen through inheritance or by a small group of prominent families or electors. But that abstract statement does not decide: which officials, if any, should be chosen not by the community as a whole but by sections or groups within it, how powers should be distributed among officials chosen in these different ways, how far elected officials should be permitted or required to appoint other officials to exercise their powers, which responsibilities should be held by elected and which by appointed officials... Though we are all democrats, these are lively political questions among us, and some are matters of heated controversy.¹⁰

For reasons we will discuss below, most actual decisions about the regulation of business will not, and cannot, be made by “the people” or even by their elected representatives. They will be crafted by bureaucrats appointed by elected officials, or more accurately, by bureaucrats appointed by other bureaucrats. Important aspects of market activity will also be constrained or sanctioned by the decisions of *judges*,

regulating business and businesses. To give a sense of the of the scale of regulatory activity, as we will discuss in section 3, below, the *Federal Register* for the calendar year 2015, which records all new and proposed regulations by the Federal government in that year, ran to 81,883 pages (three-column, letter sized paper, with one-inch margins and 9pt font).

¹⁰ Ronald Dworkin, “What is Equality? Part IV: Political Equality,” *University of San Francisco Law Review* v. 22 (1987): 2-3.

whether in contract and tort cases, presiding over administrative tribunals, or ultimately at the level of supreme or constitutional courts. So as in most realms of public policy, citizens in a democratic state are able to shape market regulations only indirectly, remotely, and incompletely. It is worth distinguishing in a rough-and-ready way at least four “governance interfaces” positioned metaphorically between citizens, at one end, and the economic actors in the marketplace who are expected to comply with regulations, at the other.

Four Governance Interfaces in a Market Democracy

- (1) The governance interface between **citizens**, on the one hand, and their **elected representatives**, on the other -- especially concerning the divergence of each group’s knowledge, preferences, values and interests, and the ability of citizens to monitor and evaluate the actions of elected officials;
- (2) The governance interface between **elected officials** and **citizens**, on the one hand, and **judges** interpreting laws and constitutional principles, and sometimes nullifying popular democratically enacted laws, on the other;
- (3) The governance interface between **elected officials** and **citizens**, on the one hand, and **the appointed officials in the bureaucracy**, on the other;
- (4) The governance interface between the rule makers in **elected office and bureaucracy**, on the one hand, and the **economic actors** (especially corporations) subjects to their laws and regulations, on the other.¹¹

Each of these “interfaces” involves a different set of “governance relationships” moving in both directions. These relationships can understood empirically, in terms of power, say, but also legally and normatively, in terms of authority, accountability, obligation, etc. E.g., A has authority over B, B is accountable to A, B tries to influence A, A monitors and oversees B, and so on. What we can say very briefly is that it would be an understatement to point out that recent democratic theorists have devoted the lion’s share of their attention to problems arising at (1): between citizens and their elected representatives.¹² Governance interface (2), on the compatibility of democracy and judicial review, has also been a widely debated “niche” issue, especially among philosophers of law.¹³ Political philosophers have devoted *considerably* less attention to (3), the question of the legitimacy of the law-making

¹¹ Depending on the issues, one could make a longer or more complex list – including one that dealt with the implications for democratic governance of global governance regimes, and multilateral treaties beyond the borders of a given nation-state. See, e.g. Allen Buchanan and Robert O. Keohane, “The Legitimacy of Global Governance Institutions,” *Ethics & International Affairs* 20, no. 4 (2006): 405-437. It goes without saying that there is a vast literature on the complex levels of governance across the frontiers of member states in the European Union.

¹² We will discuss this literature at more length in section 4, below.

¹³ See, for example, the long-running debate between Ronald Dworkin and Jeremy Waldron: including Dworkin’s *Law’s Empire* (Cambridge, MA: Harvard University Press, 1986) and *Freedom’s Law: The Moral Reading of the American Constitution* (Oxford: Oxford University Press, 1996); and Jeremy Waldron, *Law and Disagreement* (Oxford: Oxford University Press, 1999) and more recently his *Political Political Theory: Essays on Institutions* (Cambridge, MA: Harvard University Press, 2016): especially chapters 2, 3, 9.

authority of unelected regulators, or to the nature of credible mechanisms of democratic oversight of these regulatory agencies.¹⁴ In what follows we will explore the challenges in addressing these neglected issues in (3), and we will do so largely by highlighting some dilemmas that seem inevitable in governance interface (4): when regulators and the regulated meet.

2. Rule-makers, referees, and players?

Let us step back for a minute and consider these issues from the other side – that is, by focusing on powerful economic actors like corporations and corporate officers, and considering the basis for their legal and ethical responsibilities. The issues that have always piqued the interest of business ethicists are those that involve activities that are *legal*, but possibly *unethical*. Firms and individuals in the world of business usually have strong ethical obligations to obey the law (with very few exceptions), but being in compliance with the law does not guarantee that one’s actions are ethical or “socially responsible.” These are uncontroversial truisms. Yet they mask an interesting range of issues that arise when we ask the following question: *what is the appropriate, or ethically responsible, role for businesses in the processes that formulate the laws regulating their activities?* If it is usually unethical for businesses to fail to comply with laws and regulations, then it is potentially much more unethical for firms to work deliberately to weaken, “water down,” or forestall otherwise just and legitimate laws – even if they do this through perfectly legal lobbying and campaign-finance practices. As David Vogel puts it, in his discussion of the curious neglect of corporate *political* strategies in debates about so-called corporate social responsibility (CSR), “a company’s political activities typically have far broader social consequences than its own practices.”¹⁵ By protecting the irresponsible practices of a whole industry, a firm’s influence on regulatory changes can have a significantly greater impact than could its irresponsible behavior as a single “renegade” firm. *But how do we identify and distinguish the responsible and the unethical ways for corporations to engage with regulatory agencies, with courts and administrative*

¹⁴ Among the few book-length attempts by contemporary political philosophers to consider the implications of the regulatory state for justice and democracy in the liberal state are Henry S. Richardson, *Democratic Authority: Public Reasoning about the Ends of Policy* (Oxford: Oxford University Press, 2002) and N. Scott Arnold, *Imposing Values: an Essay on Liberalism and Regulation* (Oxford: Oxford University Press, 2009). But both of these books are mostly concerned with noneconomic rather than economic regulation. For a focus on economic regulation by a political philosopher, see Joseph Heath, *Morality, Competition, and the Firm*, especially “Introduction” and chapters in Parts I and II. Although the Victorian regulatory state was puny by contemporary standards, chapter XIV of John Stuart Mill’s *Considerations on Representative Government* (1861), “The Executive in a Representative Government,” is still one of the more detailed discussions by an Anglo-American political philosopher of the problems with oversight of the administrative state by elected officials. See J.S. Mill, *On Liberty and Other Essays* (Oxford: Oxford University Press, 1991): 393-410. Although we will not have space to discuss special governance issues arising in the European Union, this is a good place to flag long-standing worries about the “democratic deficit” and the “Brussels bureaucracy” as an example of a debate about governance interface (3).

¹⁵ David Vogel, *The Market for Virtue: the Potential and Limits of Corporate Social Responsibility*. (Washington: Brookings Institution Press, 2005): 171.

tribunals, and with legislators? This is, in effect, the flip-side of the questions about democracy and regulation, with which we began. Presumably our answer to the *ethics of corporate influence* question should hinge on our answer to the much larger question about the *design and justification of the constitutional democratic state* in which the firm is attempting to influence its regulations – because this will guide our thoughts about how politicians and civil servants should engage with businesses.

So what, if anything, do the central debates in contemporary political philosophy – especially about justice and democracy – say about the regulation of markets and business firms and about the role that economic actors (and other interested parties, such as consumers or employees) should have in the design and redesign of regulations? As we have indicated already, political philosophers have been almost completely silent on these questions, especially in the context of important works that aim to sketch out the institutional problem-space for which a normative theory of justice and democracy can provide guidance – Big Books like Rawls’s *A Theory of Justice*, Gutmann’s and Thompson’s *Democracy and Disagreement*,¹⁶ or even, surprisingly, Tomasi’s *Free Market Fairness*. Later we will try to highlight some of the relevant regulatory issues that a few political philosophers *have tried* to squeeze onto the agenda of their field; and we will also survey what philosophical theorists of democracy have been discussing instead.

But of course, as much as the regulatory state has been neglected by philosophers, it has been a *core* subject for colleagues in economics, political science, public policy, and law for more than half a century. Introductory textbooks in all of these disciplines have chapters on the design and rationale for regulations, and on empirical assumptions and findings about the way businesses, regulatory agencies, regulators, and politicians can be expected to act in regulated market economy. All of these academic departments (or faculties) offer multiple courses for both undergraduate and graduate students featuring regulatory issues, some of which will typically be “required;” one-third to one-half of the sub-disciplines (or sub-subdisciplines) demarcated by the *Journal of Economic Literature*, and used by the American Economic Association for its annual meetings, are integrally connected to regulation;¹⁷ about half of the Theme Panels at the 2016 annual meeting of the American Political Science Association were filled with empirical and/or normative papers involving regulation;¹⁸ and of course, almost by definition, most of the courses and most of the scholarly research in public policy and law deals directly with law and regulation. At least since the 1960s, the empirical understanding of how “interest groups,” and especially corporations, have tried to advance their interests by influencing potentially receptive regulators and elected officials has been a *major*

¹⁶ Amy Gutmann and Dennis Thompson, *Democracy and Disagreement: Why Moral Disagreement Cannot be Avoided in Politics, and What Should be Done About It* (Cambridge, MA: Harvard University Press, 1996).

¹⁷ See www.aeaweb.org/econlit.

¹⁸ See <http://community.apsanet.org/annualmeeting/conference-program/theme-statement>. Note: this link may not be accurate after the scheduled meeting in September 2016. But the themes for future years will be easy to discover.

interdisciplinary research project among scholars in these fields. The dominant – though certainly not uncontested – approach in economics and political science has been so-called public choice theory.¹⁹ As defined by one of its original architects, Gordon Tullock, “public choice uses economic tools to deal with the traditional problems of political science” and it facilitates this project by “assuming that voters, politicians and bureaucrats are mainly self-interested.”²⁰ While nobody has ever doubted that corporate actors engaging with regulators or legislators can be assumed to be trying to protect or advance their interests, even if these are not in the public interest (this process is known as rent-seeking), public choice theorists believe that our understanding of and predictions about regulatory processes will be much more accurate if we assume the same self-interested motivations on the part of elected and unelected officials in government as well.

Now it could be argued that a good explanation for the relative silence of political philosophers on the regulatory state is that there is not much for them to say on these kinds of institutional issues. There are two possible variations of this response. The first would emphasize that all of the empirical studies about how political and bureaucratic systems actually function are certainly useful when trying to reform a given state’s civil service or political culture, but the political philosopher’s job is to articulate and defend the *principles* of justice and democracy that such systems should be designed to satisfy or realize. A second variation of the response would be that there is nothing especially interesting or challenging about the ethics the self-serving bureaucrats or politicians of the sort that public choice theorists postulate. Rawls, for example, simply takes it for granted that:

one who assumes public office is obligated to his fellow citizens whose trust and confidence he has sought and with whom he is cooperating in running a democratic society. Similarly, we assume obligations when we marry as well as when we accept positions of judicial, administrative, or other authority. We acquire obligations by promising and by tacit understandings, and even when we join a game, namely, the obligation to play by the rules and to be a good sport.

In short, political philosophers may justify a lack of attention to the obligations of regulatory agencies, individual regulators, and the firms they regulate for reasons similar to those expressed in Bob Dylan’s line, “you don’t need a weatherman to

¹⁹ To mention only some early and massively influential works in this tradition: James Buchanan and Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (Ann Arbor: University of Michigan Press, 1962); George Stigler, “The Theory of Economic Regulation,” *Bell Journal of Economics and Management Science* 2, no. 1 (1971): 3-21; Gary S. Becker, “A Theory of Competition Among Pressure Groups for Political Influence,” *Quarterly Journal of Economics* 98, no. 3 (1983): 371-400; Jean-Jacques Laffont and Jean Tirole, “The Politics of Government Decision Making: a Theory of Regulatory Capture,” *Quarterly Journal of Economics* 106, no. 4 (1991): 1089-127. For a very assessment of both the empirical success of public choice models, along with an evaluation of their policy prescriptions, see Daniel Carpenter and David A. Moss, eds, *Preventing Regulatory Capture: Special Interest Influence and How to Limit It* (Cambridge: Cambridge University Press, 2014).

²⁰ Gordon Tullock, “Public Choice,” in Steven N. Durlauf and Lawrence E. Blume, eds, *The New Palgrave Dictionary of Economics*, 2nd edition (New York: Palgrave Macmillan, 2008).

know which way the wind blows.”²¹ You don’t need a political philosopher to know that corruption is wrong and that conflicts of interest are corrosive.

The rest of this paper will suggest several reasons for thinking that neither the empirical unsavoriness of actual business-government relations, nor the “obviousness” of how politicians and regulators ought to behave, can justify the neglect of the regulatory state by normative theorists of justice or democracy. Let’s consider again the seemingly innocent metaphor of a “division of labor” between governments and market actors, which we find across the political spectrum and have already cited in the work of Friedman on the right and Rawls on the left. This metaphor overlaps with the idea of a “sporting contest” in which the government’s role is as both a forum for deciding on the “rules of the game” involving markets and business “players,” and a neutral “umpire” to interpret and enforce these rules. The players themselves are invited to play to win (to pursue their own interests), as long as they obey the rules. Again, across the liberal spectrum – from “classical” liberals on the right to “modern” or “deontological” liberals on the left – the rule-making and refereeing roles for government in a market economy are necessary because of the inevitability of market failures and temptations of market actors to engage in coercive, collusive, deceptive, or exploitative business practices that undermine the efficiency and fairness of markets.

Of course Rawls and Friedman take seriously the ever-present threat of corruption when market, forum, and referee meet. Indeed, the ways in which their visions of a “realistic utopia” diverge fundamentally can be traced in large part to how they interpret and prioritize the dangers of economic influence on politics, and of political influence on the economy. Friedman champions capitalism in large part because he believes it “promotes political freedom [by separating] economic power from political power and in this way enables the one to offset the other.”²² Most of his political writings place a heavy emphasis on the costs, in terms of economic efficiency and individual freedom, of what he sees as the wrong kind of meddling in the market. Whereas Friedman is mostly concerned with the way politicians and bureaucrats corrupt the economic system, Rawls worries more about the way the economic system can corrupt the political system and its ability to create and sustain a just society. In but-a-handful of sentences across his three books on justice, Rawls rules out the *very possibility* of capitalism in a just society – even *welfare-state* capitalism – in large part because he cannot see how the high concentration of economic power foreseeable in a capitalist economic system will not also lead to a high degree of political inequality (an unequal worth of political liberties) favoring the wealthy.²³

²¹ Bob Dylan, “Subterranean Homesick Blues,” from the album *Bringing it all Back Home* (New York: Columbia Records, 1965).

²² Friedman, *Capitalism and Freedom*: 9.

²³ See Rawls *A Theory of Justice*: xv; and John Rawls, *Justice as Fairness: A Brief Restatement* (Cambridge, MA: Harvard University Press, 2001):137-139,149. Rawls rejects both capitalism and bureaucratic, centrally planned socialism – the “only two ways of coordinating the economic activities of millions,” according to Friedman (*Capitalism and Freedom*: 13). Rawls thinks he can nevertheless remain committed to a system using government-regulated markets and firms not controlled directed

In short, using Friedman and Rawls to stake out the right and left of the market-democracy spectrum, we return to the following shared assumption: *to ensure the proper functioning of both democratic governance and a market economy the regulators and the regulated operating within these two systems must stick to highly circumscribed roles with respect to each other; and that if they do not, then either system is likely to corrupt the other.* Moreover, we can generally predict, as reliably as we can predict anything in political science, some of the specific ways one set of institutions *will* corrupt the other. Rawls is hardly courting controversy when he assumes that highly concentrated economic power will enable those in possession of it to be “more equal” than others in democratic decision-making. Again, generations of political scientists and economists – and not only public choice theorists – have now explored various ways even well-intentioned politicians and regulators are prone (though not doomed) to erring in their task of drafting and enforcing the appropriate “rules of the game” for markets and businesses. These kinds of problems are surely, as Rawls said of value pluralism, a *fact of life* in market democracies. Unintended consequences of regulatory interventions are difficult to predict, and there are so many opportunities for actors on both sides to seek mutually beneficial private arrangements to the detriment of the public. More campaign funding for a politician, or the potential for a higher-paying future job in the private sector for a civil servant, can lead to a very profitable regulatory reform for a business or business sector. Such conflicts of interest are corrosive even when the conflicted individuals themselves are consciously trying to act with the most public-spirited of intentions. To adapt an oft-quoted passage from Smith’s *Wealth of Nations*: when regulators and the regulated meet, even for merriment and diversion, the conversation often ends in conspiracy against the public.²⁴

How can we protect democracy from such conspiracies? The strict division of labor that seems to be assumed by many democratic theorists does so by limiting the interaction between regulators and the regulated. This strategy follows Smith’s solution to the problem of collusion among competitors: “though the law cannot hinder people of the same trade [or, we might now add, regulators and the regulated] from sometimes assembling together, it ought to do nothing to facilitate such assemblies, much less to render them necessary.”²⁵ So long as regulators and the regulated are kept apart—confined to their distinct roles and acting autonomously of one another, inside and outside “the Beltway,”²⁶ so to speak—the risk of conspiracy against the public can be minimized. Insofar as current societies fall short of such a

by the state, because he thinks this basic plumbing can operate within certain proposed models of liberal socialism and so-called property-owning democracy (Rawls, *A Theory of Justice*: 265-284; *Justice as Fairness*: 135-179). Thus Rawls remains within the market-democracy consensus because he thinks there are viable non-capitalist market systems compatible with justice and democratic equality.

²⁴ The original passage is from Adam Smith’s *Wealth of Nations*, Bk. 1, Ch. 10, Para. 82: “People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.”

²⁵ *Ibid.*

²⁶ The Capital Beltway is a ring road (Interstate Highway 495) around Washington D.C. and its suburbs; it serves as the metaphorical frontier between the political and bureaucratic insiders of the US federal government, on the one hand, and “the rest of America,” on the other.

clean division of labor, we ought to work to re-establish it. Or so, at least, is the thought that seems implicit in the passing references to economic regulation that we typically find in political philosophy. Businesses and their advocates are free to participate in public debates and deliberations about economic policy (perhaps within spending limits that prevent their messages from drowning out those of less powerful citizens); but it is ultimately for the people and their representatives to decide upon policies in the public interest; and the civil servants' job is to "implement" rules within the parameters of legislation, and to enforce the rules impartially. All of this sounds pretty reasonable, and to the extent that it is, it obviates the need for deeper philosophical consideration of the relationship between governments and businesses. And yet, we contend, it is a thought that is deeply mistaken.

3. The Democratically Uncomfortable Reality of the Regulatory State

One can imagine a time when the "division of labor" between the regulators and the regulated would have made perfect sense. In the early days of the industrial revolution, for instance, the dangers in need of regulation were easy to spot, smell, feel, and understand – the factories springing up across the country used hot steam to drive heavy machines that could easily crush a man, woman, or child. The lighting was often dim, and the poor ventilation was evident to anyone with unobstructed nostrils. Perhaps there was even a different class – literally a different class – of people who ran businesses, on the one hand, or took up careers in the civil service, on the other. The latter may well have been more educated in basic science and political economy than the former, and at any rate, such civil servants would not have envied the careers of the former, and not have seen a future for themselves in the industrialist's world, which was quite likely as geographically as it was socially and culturally remote. We are simply speculating here. If there ever was such a time in which the integrity and efficiency of the regulated economy could be preserved by a strict division of labor between players and umpires, that time is not ours.

For one thing, it is difficult to know what it would mean for the individuals who work for the civil service and those who work for industry to be "isolated" or "kept apart" from each other in any real sense. And it would be self-defeating to attempt to build Chinese walls to prevent the two groups from engaging with each other in the process of developing, monitoring, enforcing, and revising regulatory rules and standards in a world characterized by rapidly evolving technologies. The regulatory challenges facing modern societies would be as unrecognizable to Victorians as our modern modes of communication are. Consider the complexity of the financial sector, or the knowledge needed to evaluate pharmaceuticals, to encrypt data, or to keep on top of the daily evolution of algorithms-communicating-with-algorithms that coordinate the "Internet of things."²⁷ Successful regulation in these

²⁷ There is an abundance of recent scholarship on the empirical, political, and legal challenges of regulation in each of these areas. We recommend the first five chapters in Part V of R. Baldwin, M. Cave, and M. Lodge, eds, *The Oxford Handbook of Regulation* (Oxford: Oxford University Press, 2010). But even as non-experts in the domains of financial services, telecommunications and network

and many other arenas requires expert knowledge, and, now more than ever, the leading experts in many fields are typically employed by *firms* competing within the market rather than by *government* labs or agencies. This is especially true in the case of rapidly advancing technologies requiring high levels of expertise from the very people developing the science and technology: from Internet security and biotechnology, to driverless vehicles, and international supply-chain management. Smart and effective regulation cannot be developed without input from, and coordination with, the firms being regulated. In short, regulators are unavoidably and epistemically *dependent* on those they are tasked with regulating. And even when regulators do possess advanced general expertise of their own, efficient regulation and enforcement nonetheless requires significant and on-going input and cooperation with specific firms about their processes, products, modes of compliance, and about unintended perverse consequences of existing regulations. As the market equivalent of “referees,” “performance-enhancing-drug testers,” and “video-replay judges,” officials have to be in or near the arena of commerce to ensure compliance and to learn about the consequences of regulatory policies and laws.

In section 4, below, we will look briefly at debates among contemporary democratic theorists about the “epistemic” virtues of large-scale public deliberations and voting procedures involving the citizens of a democratic state. But to appreciate the challenge of policies and laws embodying state-of-the-art knowledge, we must grasp the sheer scale of lawmaking that happens at what we earlier called “governance interface (4)” – the interface that mostly engages not citizens but the regulators and the regulated. We can all gain perspective in democratic theory if we spend some time with the annual compendium of regulatory activity that modern bureaucracies now make available. During the first Obama administration (2009-2012) the US federal regulatory state was officially supervised by a major figure in the political theory of the modern constitutional democracy, Cass Sunstein. His official title was: Administrator of the White House Office of Information and Regulatory Affairs. And during his “reign” as “Regulation Czar,” and since, the activities of all US federal regulatory agencies have become steadily more publicly accessible and transparent. They reveal a scale and a scope of the largely invisible lawmaking by regulators in every modern state (as well as the European Union) that fits uncomfortably with assumptions of popular sovereignty among the general public and political philosophers alike.

As noted earlier, the *Federal Register* records all new proposals for regulation, new regulations, notices of upcoming regulatory processes, and Executive Orders in the US federal government. In 2015 – a year many will remember for its gridlock within the U.S. Congress, and between the Congress and the “lame-duck” second-term President from the other party – the *Federal Register*, v. 80 was **81,883 pages long** – about the same length it has been every year recently. By rough calculation, that is about 110 million words, which is the equivalent of more than 100 copies of

industries, code, encryption, and cyberspace, we can see that the regulatory challenges are already more daunting, less than a decade after these chapters were written.

the *Complete Works of Plato*; or to give a less historically significant comparison, it is the length of more than 13,000 articles like the one you are currently reading. It has been estimated that it would take one brave and careful reader, working 40 hours a week, more than four years just to *read* the *Federal Register* from 2015.²⁸ And no matter who that person was, he or she would not be capable of evaluating, justifying, or criticizing the wisdom of more than a tiny proportion of the newly minted regulations. And of course it goes without saying that the *Federal Register, v. 80* does not contain the regulations produced in 2015 by civil servants working for state, local, or tribal governments in the US. Nor the body of the existing regulations approved before 2015. Finally, as we noted in a footnote in the introduction, we estimate that between two-thirds and three-quarters of the content of the *Federal Register* is concerned with economic and commercial regulation, and not with the kinds of “welfare state” or civil rights issues that typically attract the attention of political philosophers.

The monumental scale and scope of the bureaucracy’s role in lawmaking is often framed as a kind of “democratic deficit” – citizens and their elected officials are not well-placed to oversee and evaluate, let alone to understand or debate, the vast majority of what has the force of law in modern democracies. Does normative democratic theory offer a democratic solution to this deficit? As we have noted already, most of these theories are preoccupied with how we ought to bridge gaps of preferences, interests, knowledge, and accountability between *citizens* and their *elected representatives* – what we called “governance interface (1).” In what way might our understanding of the stakes and solutions at that interface help us to conceive of a democratically robust understanding of governance at interfaces (3), between citizens and elected officials, on the one hand, and appointed officials in the administrative agencies, on the other; or (4) between those appointed regulators and the economic “players” they must regulate? We will return to this question, and a dilemma it poses, in section 5, below. In the meantime, we must be more explicit about some aspersions we have cast in the direction of recent democratic theory.

4. Guidance from Contemporary Democratic Theory?

One explanation for why questions about government oversight of the market and commerce have been largely absent from the agenda of normative democratic theory can be traced from the level of abstraction and generality at which much democratic theory operates. David Estlund begins his celebrated book *Democratic Authority* with an explicit disclaimer to this effect. He writes:

[T]he idea that something is gained if political philosophers explain how to put their ideas into practice is hard to understand. If the more abstract arguments are of any value, then it would be good if someone takes up the further questions about what they might imply or recommend in practice, and

²⁸ Susan E. Dudley and Jerry Brito, *Regulation: A Primer* second edition (Washington, D.C.: Mercatus Center at George Mason University, 2012).

I do not mean to denigrate that task. My main concern, however, is with the question whether certain points at a fairly abstract level are of value in the first place, whether they solve or at least contribute to the solution of important problems that lie at the more abstract level. As a result, few institutional specifics are offered here, and when they are they are mainly meant as illustrative examples, not as prescriptions.²⁹

Estlund is far from an outlier in this regard. Many leading democratic theorists take their primary task to be providing a defense of some abstract conception of *democracy itself*. They aim to explain why democracy is normatively desirable, or why democracy, perhaps uniquely, can have legitimacy and authority.

Competing democratic theories emphasize different values or benefits as the source of democracy's appeal. Some say it is the realization of an ideal of political equality,³⁰ others point to the need for public justification in the face of moral disagreement.³¹ Recently several theorists have emphasized the *epistemic* merits of democracy, seeking to defend it against systems touted to be epistemically superior such as technocracy or "epistocracy."³² While such accounts may elucidate the fundamental normative principles upon which democracy rests, there is no quick and easy route from those principles to a set of institutions that "embody" them, especially when those institutions, such as regulatory agencies, do not themselves operate by democratic decision procedures. (Recall Dworkin's point, discussed in the introduction, about the crucial institutional questions remaining open even after we have opted for standard democratic rights of citizenship.)

Consider the excellent entry on "Democracy" in the *Stanford Encyclopedia of Philosophy* penned by a leading figure among philosophical theorists of democracy, Thomas Christiano. The entry is built around a survey of four issues that have dominated contemporary democratic theory. Two of the issues concern the sort of abstract and foundational questions discussed above: "why is democracy morally desirable at all" and "whether and when democratic institutions have authority." The other two are more specific questions about citizens and their representatives: "what it is reasonable to expect from citizens in large democratic societies" and "[what is] the

²⁹ David Estlund, *Democratic Authority: A Philosophical Framework* (Princeton, N.J.: Princeton University Press, 2008), 2.

³⁰ Thomas Christiano, *The Constitution of Equality* (Oxford: Oxford University Press, 2008); Charles Beitz, *Political Equality: an Essay on Democratic Theory* (Princeton, Princeton University Press, 1989).

³¹ John Rawls, *Political Liberalism*, Expanded ed. (New York: Columbia University Press, 2005); Joshua Cohen, "Procedure and Substance in Deliberative Democracy," in *Philosophy and Democracy*, ed. Thomas Christiano (Oxford: Oxford University Press, 2002); Estlund, *Democratic Authority: A Philosophical Framework*.

³² Joshua Cohen, "An Epistemic Conception of Democracy," *Ethics* 97, no. 1 (1986): 26-38; Estlund, *Democratic Authority: A Philosophical Framework*; Cheryl Misak, "A Culture of Justification: The Pragmatist's Epistemic Argument for Democracy," *Episteme: A Journal of Social Epistemology* 5, no. 1 (2008); Hélène Landemore, *Democratic Reason: Politics, Collective Intelligence, and the Rule of the Many* (Princeton, N.J.: Princeton University Press, 2013); Jack Knight and James Johnson, *The Priority of Democracy: Political Consequences of Pragmatism* (Princeton: Princeton University Press, 2011).

proper characterization of equality in the processes of representation.”³³ Questions about the regulatory state, or what we characterized at the outset as governance interfaces (3) and (4) are absent. In fact, it appears from the general definition Christiano offers that the latter two governance interfaces get framed out of the discussion:

To fix ideas, the term “democracy,” as I will use it in this article, refers very generally to a method of group decision-making characterized by a kind of equality among the participants at an essential stage of the collective decision-making.

He clarifies this definition by emphasizing, among other things that “democracy concerns collective decision-making, by which I mean decisions that are made for groups and that are binding on all the members of the group.” And also that democracy “may involve direct participation of the members of a society in deciding on the laws and policies of the society or it may involve the participation of those members in selecting representatives to make the decisions.” Christiano’s survey accurately reflects the landscape of contemporary democratic theory.³⁴ Since the emergence of the deliberative democracy paradigm in the mid-1980s,³⁵ and continuing still with some of the successors to this model,³⁶ democratic theorists have concentrated heavily on the roles, rights, obligations, and virtues of citizens and their elected representatives *in the process of decision-making*.

So why do we say that this removes most of the issues of the regulatory state from the problem space for political philosophers? The main clue is the exclusive focus on *decision-making*. It presumes the *kind of thing* that can be democratic is a *decision-making process for a group*. That group may democratically decide to let others (their representatives) make decisions for them. And as Dworkin reminds us in the long quote we looked at in the introduction, those representatives may decide to let others (bureaucrats, judges, military officers, or even market participants) make the more detailed decisions. There is no reason whatsoever to assume that in a

³³ Tom Christiano, “Democracy,” *The Stanford Encyclopedia of Philosophy* (Spring 2015 Edition), Edward N. Zalta (ed.), URL = <<http://plato.stanford.edu/archives/spr2015/entries/democracy/>>. Subsequent quotes from Christiano in this section are drawn from this article.

³⁴ Faithfully surveying the predominant debates among contemporary philosophical theorists of democracy was Christiano’s mandate in the *SEP* entry we have been quoting from here. We hasten to add that our general critique of that mainstream tradition, as he characterizes it, does *not* apply directly to Christiano’s own work. He has in places explicitly attempted to connect the dots of the governance interfaces – especially (1) and (3), though less so in the case of (4). We must save for another occasion our examination of his theory of the division of labor between citizens and legislators, on the one hand, and bureaucrats, on the other. See Christiano’s *The Rule of The Many: Fundamental Issues in Democratic Theory* (Boulder, CO: Westview Press, 1996): especially chapter 5; his “Rational Deliberation Among Experts and Citizens,” in John Parkinson and Jane Mansbridge, eds, *Deliberative Systems: Deliberative Democracy at the Large Scale* (Cambridge: Cambridge University Press, 2013); and his debate with Henry Richardson in “Democracy and Bureaucracy,” *Philosophy and Phenomenological Research* 71, no. 1 (2005): 211-217.

³⁵ Jürgen Habermas, *Between Facts and Norms: Contributions to a Discourse Theory of Law and Democracy*, trans. William Rehg (Cambridge, MA: MIT Press, 1996); Amy Gutmann and Dennis Thompson, *Democracy and Disagreement: Why Moral Conflict Cannot Be Avoided, and What We Should Do About It* (Cambridge, MA: Harvard University Press, 1996).

³⁶ John Parkinson and Jane Mansbridge, eds., *Deliberative Systems: Deliberative Democracy at the Large Scale*.

democratic state the other delegated decision makers should themselves be making decisions according to a democratic procedure: indeed, we typically want them to make decisions within some kind of hierarchical organizational structure where certain officers are ultimately accountable for what is decided and what is done. So we could say that in a well functioning democratic state, many layers of decision-making within the government must be carried out undemocratically. (This should not be paradoxical for Christiano, since he insists that his “definition [of democracy] is not intended to carry any normative weight to it. It is quite compatible with this definition of democracy that it is not desirable to have democracy in some particular context.”) But there is still something peculiar about this framing of democracy as a property of *decision-making procedures*.

What about *ruling*? Since the time of the Greeks, who gave us the word, it has been standard to think of democracy as “rule by the people,” in contrast with alternatives like aristocracy or tyranny, where other kinds of individuals or groups rule. Our point isn’t etymological, however. Ruling is about the *effective overall governance* of a group or organization or community. And good decision-making is just a *part* of good governance. Governance is also about *doing* what has been decided upon, and doing it in the right way, even; and then about making sure others do what they are expected to do, given their role in the governance structure (a role typically defined in part by who is “above” and “below” a chain of authority and accountability); about learning and adjusting to new information throughout the chain of governance; and so on.

What good is pristine democratic decision-making if those with power after the decisions have been made are able to ignore those decisions or otherwise use state power to pursue their own interests even when this undermines the “will of the people”? This is not a rhetorical question. It is pretty close to the challenge that a large contingent of mainstream political scientists, and not only public choice theorists, have laid down for political philosophers over the past half century: how should we think about good governance in a constitutional democracy if we cannot simply take for granted that citizens, elected officials, and bureaucrats will be motivated to advance the public good, or to carry out the duties of their offices when their private or career interests can be advanced in other ways? Trying again not to belabor the point: political philosophers have readily taken these built-in conflicts of interest into account at governance interfaces (1) and (2) when thinking about very particular designs for deliberative procedures for citizens, electoral systems, and constitutional power-checking arrangements for the interface between citizens, representatives, and courts. There has been much less attention to the tensions between the norms and motivations generated for elected officials by the fierce competition for power at the heart of democracy, on the one hand, and the duties of governance for these officials, on the other.³⁷ And again, virtually none for the

³⁷ The subtitles of two important recent books taking up this challenge are informative. See Amy Gutmann and Dennis Thompson, *The Spirit of Compromise: Why Governing Demands it and Campaigning Undermines it* (Princeton: Princeton University Press, 2012); and Nancy Rosenblum, *On*

oversight of civil servants, who even when well intentioned are subject to heuristics, cognitive bias, organizational cultures, and career pressures that expose them to “cultural” capture by those they are regulating, or incentivize bureaucratic empire-building to preserve or enhance their power within the civil service itself.³⁸

By insisting here that a normative theory of democracy should be about *governance* and not merely about *decision-making* we are not making some kind of linguistic or definitional point, as if these were simply two different kinds of things to which the adjective “democratic” can properly apply. A theory of governance, or government, is ultimately what political philosophers should be providing guidance on – as they did from Plato and Aristotle to *The Federalist* or Mill’s *Considerations on Representative Government*. In recent decades political philosophers seem to have become obsessed with increasingly rarified debates about when a government policy or activity is *just*, and when the deliberations about, and decision on, government policies can be considered *democratic* – but everything in between, so to speak, is either ignored or assumed to be a matter of practical, empirical political engineering. What we have been calling the governance interfaces (3) and (4) are part of that “everything in between” the question about how the citizens make certain decisions (e.g., in electing representatives), and whether the policies and actions carried out by their government (including the proposals, announcements, and new regulations that fill more than 80,000 pages in the *Federal Register* every year in the US) are just and fair. A theory of democracy has to include, among many of the constituents of good governance, a theory of democratic oversight and accountability of the regulatory state.

5. A Dilemma for Smart Regulation and Epistemic Democracy

We return now to the challenges for a democratic theory of the regulatory state that we laid out in sections 2 and 3, above. And we do so by taking seriously the idea sketched in section 4: that such a theory should not be framed as an attempt to trace a faint democratic genealogy from the general deliberations of citizens during periodic election campaigns all the way down the thousands of pages of dense technocratic rules developed each year to regulate business – as if we could simply count on dutiful civil servants to divine and faithfully “work out the details” and “implement”

the Side of the Angels: an Appreciation of Parties and Partisanship (Princeton: Princeton University Press, 2008). The debate between those penning the opinions of the majority and minority in SCOTUS, *Citizens United v. Federal Election Commission* (2010) is also about the interplay between different conceptions of democratic rights and the potential corruption of the political class by the economic actors they are supposed to regulate in the public interest.

³⁸ See, e.g., the following chapters in Daniel Carpenter and David Moss, *Preventing Regulatory Capture: Special Interest Influence and How to Limit It* (Cambridge: Cambridge University Press, 2014): Carpenter and Moss, “Introduction,” 1-22; Richard Posner, “The Concept of Regulatory Capture: a Short, Inglorious History,” 49-56; Carpenter, “Detecting and Measuring Capture,” 57-68; James Kwak, “Cultural Capture and the Financial Crisis,” 71-98. On “empire building” see the bureaucratic encyclopedia that was the 1980s British sit-com *Yes, Minister* and *Yes, Prime Minister!* Jonathan Lynn and Anthony Jay, *The Complete Yes Minister* (London: BBC Books, 1984), which is discussed in the context of bureaucratic theory by James Brander, *Government Policy Toward Business* (Toronto: John Wiley & Sons, 1995): 118-21.

the wishes of the people and their elected representatives.³⁹ Rather, it should be a theory that explains how (if at all, or to what degree) the bureaucratic authors of those dense regulations could plausibly be monitored by, and held accountable to, the elected officials and the citizens of a constitutional democracy.

The challenge at governance interfaces (3) and (4), as we have framed it thus far is, to put it bluntly, an agency problem⁴⁰ that is massively more complex than the one faced by, say, a large multinational corporation with widely dispersed private ownership. Consider the following summary of some relatively uncontroversial facts about the regulation of markets in a modern economy. First, recall that our subject matter throughout has been on the regulation of *businesses and markets* in a constitutional democracy, even if some of the issues are equally germane in areas of non-economic regulation. Recall also:

- that the prime (though not the only) rationale for the regulation of markets arises out of market failures which allow firms to profit in ways that undermine the efficiency and fairness justifications for markets (and hence the public interest);
- that the real details of most laws for business are worked out by regulatory agencies, and these market regulations are what fill the majority of the roughly 80,000 pages in the US *Federal Register* each year;
- that regulators need information of many kinds, for different reasons, *from the parties affected by regulations, especially the business firms that will have to comply* with these rules and laws: (a) they need information on the costs to some parties, and on the benefits to other parties, of regulations or regulatory proposal, and some of this can only come from self-reporting by firms; (b) to estimate the costs, they need to try to anticipate the way market actors will respond to potentially perverse incentives from new regulations, perhaps in ways that thoroughly undermine the point of the regulations;⁴¹ (c) increasingly in high-tech and financial services, the staff in the regulatory agencies may *know much less* about the product or service in question than the firm will (especially in the case of technologies that are invented within the firms, and involve proprietary intellectual property); (d) regulators have to be able to monitor the impact of regulations after the fact, and again, this will require knowledge of costs and benefits that must be reported by the firms themselves; and so on;

³⁹ The fallacy to be avoided here is similar to the target of Henry Richardson's critique of what he calls "agency instrumentalism" in his *Democratic Authority: Public Reasoning about the Ends of Policy*: especially Part II, 97-176.

⁴⁰ See Eric Beerbohm, *In Our Name: The Ethics of Democracy* (Princeton: Princeton University Press, 2012).

⁴¹ To take a simple non-economic example: it appears that outright bans on texting while driving have led to more accidents caused by texting while driving – because drivers respond by holding their phones lower, out of view of any police, and this keeps their eyes off the road even longer.

- that in sophisticated regulated market economies like the US or the EU, interested parties *have the right* to make their case, in public and typically also in private, when proposed regulations will affect them;⁴²
- that in addition to taking for granted that *business firms* will be trying to advance their own interests (rent-seeking) when interacting with regulators, we cannot ignore the ever-present possibility that *regulatory agencies* and *individual regulators* will also be tempted to advance their own private interests when, unwittingly or eyes-wide-open, they are “captured” by the industry they are regulating in any of a variety of ways.

None of these points is particularly controversial within the disciplines that study business-government relations – although obviously, researchers and scholars can disagree about the extent to which these statements are true in any specific regulatory context.⁴³ These claims, taken together, frame some key points of reference for what we have been calling the challenge of governance interface (4): between the regulators and the regulated. It is the challenge masked by the presumption that markets should have “players” and “referees” and never the twain shall meet.

With all of this in mind, consider the following:

The Democrat’s Regulatory Dilemma

(A) We can try to reinforce the independence and integrity of market regulators by building a Chinese wall between the regulators and regulated. But given the information regulators need before, during, and when reviewing regulation retrospectively, this would give us a regulatory regime that will increasingly take on *for real* all of the criticisms of outdated, bureaucratic, counterproductive, red-tape-generating, job-destroying regulation that are already red-meat for the pro-business lobby. Or

⁴² Cass Sunstein’s account of the right for interested parties to participate in the process, and also his first-hand observations on how they typically try to use this access, is fascinating. See Cass Sunstein, *Valuing Life: Humanizing the Regulatory State* (Chicago: University of Chicago Press, 2014): 31-6. For a comparison of regulatory processes, including the permitted or obligatory channels of dialogue between regulators and interested parties across the OECD, see OECD, *Recommendations to the Council on Regulatory Policy and Governance* (Paris: OECD Publishing, 2012): <http://dx.doi.org/101787/9789264209022-en>, and Andrea Renda, “Regulatory Impact Assessment and Regulatory Policy,” in OECD, *Regulatory Policy in Perspective: A Reader’s Companion to the OECD Regulatory Policy Outlook 2015* (Paris: OECD Publishing, 2015): 35-114.

⁴³ Steven Croley, *Regulation and Public Interests: The Possibility of Good Regulatory Government* (Princeton: Princeton University Press, 2008): especially chapters 2-3. Some agency may have exhibited great independence and *esprit de corps* in one decade, but have become a textbook example of a captured agency a decade or two later. The experts employed by the government within one particular department may know as much or more than the industry experts about the (say, harmful) nature of a product and how to reduce the harm; whereas in another department, the functionaries may be almost entirely beholden to the experts from the industry to help them to understand the nature of the technology and the likely costs and benefits of regulatory interventions.

(B) we encourage regulators and those they regulate to collaborate more closely to develop and monitor systems of regulation that can respond quickly to experience and technological change. But this is more likely to lead *for real* to what is often merely presumed by public choice theorists: regulations being tailored to the interests of the firms and the individual public officials – at the expense of the public interest.

Is there any viable, institutionally sustainable alternative to the two unacceptably sharp horns of this dilemma? How can we have the smart regulation necessary for fair and efficient markets in an age of rapid technological innovation and change without “conspiracies against the public”?

6. Toward a New Agenda for Democratic Theorizing about a Real Economy

Of course we have no magical theory – or institutional designs – to pull out of a hat to solve this dilemma in the abstract or in practice. What we have tried to suggest very quickly here is that in order to get serious about this problem democratic theorists will have to rethink and replace a number of long-standing, assumptions about supposed divisions of labor between business and government, elected officials and bureaucrats, and citizens and elected officials; and also about the proper scope of normative democratic theory. In this final section we have space to do no more than illustrate the kind of contribution normative democratic theorists could make to debates about the regulatory state that have thus far been carried on almost entirely by lawyers and social scientists. The dilemmas and governance challenges we have been building up throughout this article need not be seen as intractable.

A first step for thinking productively about governance in the regulatory state is to recognize that it is a complex system with multiple sources of power, control, information, and oversight; not simply a mass of civil servants housed in functional departments and feeding their regulatory decisions to the office that publishes them in their country’s version of the *Federal Register*. For a realistic sense of the kind of internal architecture for a responsible and responsive regulatory state, we could do worse than to begin with what Cass Sunstein has called “a kind of mini-constitution for the regulatory state [in the US federal government], and one whose fundamental orientation has strong Millian features,” namely the *Executive Order 13563* of January 18, 2011.⁴⁴ It is like a constitution because it sets out, in under four pages, the principles and procedures that several different units within the White House will use to evaluate and justify all new and existing regulations that are developed in the administrative agencies which the US Constitution assigns to the executive. Among other things this document states “General Principles of Regulation,” rules for “Public

⁴⁴ Sunstein, *Valuing Life*: 17. Sunstein himself helped to craft this Executive Order while in the role as “Regulation Czar” in the Obama White House from 2009-12, though it clearly, as he puts it, “reaffirms and incorporates *Executive Order 12866*” issued by President Clinton in 1993. We lapse into American parochialism here only for reasons of space. See the next footnote for excellent surveys of comparable regulatory “constitutions” in other OECD states and the EU.

Participation” in the development of regulations, the special role for “Science” and objectivity, and – intriguingly for democratic theory and for responsible business participation in the process – guidelines for the mandatory “Retrospective Analysis of Existing Rules” on regular basis.⁴⁵ Like its predecessors, this Executive Order emphasizes *cost-benefit analysis* as a *necessary* tool for both initial and retrospective approval of all federal regulation. “[Any regulation] must identify the best, most innovative, and least burdensome tools for achieving regulatory ends. It must take into account benefits and costs, both quantitative and qualitative... It must measure, and seek to improve, the actual results of regulatory requirements.”⁴⁶ As Sunstein explains, using literally dozens of mini case studies, the cost-benefit standard in this Executive Order requires that benefits must *justify*, not necessarily *exceed* or *outweigh*, the costs. He gives numerous examples where benefits that might be technically lower than the costs nevertheless justify such costs – e.g., when there are salient issues involving a skewed distribution of the benefits and burdens of a proposed regulation (say, with burdens falling heavily on an already disadvantaged group), or when the importance of some human costs or benefits that cannot be easily quantified (such as the benefit from a reduction of prison rape expected from a costly reform involving significant expenses for educating prison employees), or because of some kinds of uncertainty in the projections of costs and benefits.⁴⁷

So what is philosophically interesting about this “regulatory constitution” that the executive branch of the US government has given itself? For one thing, it spells out principles for justifying regulatory law in the abstract, as well as procedures and chains of authority and oversight for justifying (or rejecting) particular regulatory proposals in practice. It is not merely a statement of general duties for regulators to find the best means to implement aims democratically decided upon by the citizens to whom they are subordinates – i.e., as their “civil servants.” In other words, it is a system of *governance*. The White House office that oversees all of the regulatory agencies – the Office of Information and Regulatory Affairs (OIRA) – is relatively young. It was created by something charmingly called the *Paperwork Reduction Act of 1980*, and according to Sunstein it typically consists of fewer than 50 people, “most of them career staff” rather than political appointees.⁴⁸ OIRA is given the responsibility to review, approve, or decline to approve all rules from federal executive agencies. And as such it exists to address some of the classic “capture”

⁴⁵ Regulatory Impact Analysis (or RIA) may be the hottest topic and institutional-design challenge both in regulatory regimes around the world, and in academic work on regulatory governance in the second decade of the 21st century. See Andrea Renda, *Law and Economics in the RIA World: Improving the Use of Economic Analysis in Public Policy and Legislation* (Cambridge: Intersentia, 2011). This book, along with Renda’s survey for the OECD, “Regulatory Impact Assessment and Regulatory Policy,” cited already, provide comprehensive comparative surveys of regulatory governance mechanisms across the developed economies of the world.

⁴⁶ Cost-benefit analysis is required for regulation in the UK on similar grounds and with a similar sensitivity to the valuation of non-market goods. See: HM Treasury, *The Green Book: Appraisal and Evaluation in Central Government* (London: TSO, 2013) (<https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-government>).

⁴⁷ Sunstein, *Valuing Life*: 36-42, 47-64.

⁴⁸ Sunstein, *Valuing Life*: 16.

worries summarized in option (B) of the dilemma above. While some individual agency developing (or relaxing) a regulation may have become too cozy with the industry it polices, it should be less likely that the more remote team of generalists in OIRA will have been similarly captured. Sunstein stresses that OIRA's most important function is not merely as a gatekeeper, however:

One of my central themes is that OIRA helps to collect widely dispersed information – information held throughout the executive branch and by the public in general. OIRA is largely in the business of helping to identify and aggregate views and perspectives of a wide range of sources both inside and outside the federal government... OIRA is to operate as a guardian of a well-functioning administrative process, to ensure not only respect for law but also compliance with procedural ideals, involving notice and an opportunity to be heard... that might be loosely organized under the rubric of “regulatory due process.” Indeed, OIRA helps to promote a system of deliberative democracy, which is a crucial safeguard against error.⁴⁹

There is much to explore more deeply about these roles for an elite office like this within a bureaucratic system, and Sunstein helps to fill it out in this book of bureaucratic confessions we have been quoting from. We simply want to suggest these are exactly the kinds of epistemic, fairness, voice, and accountability functions that philosophically inclined democratic theorists should recognize as their proper domain of study, even though we are concerned here with deliberations and decision-making among bureaucrats rather than among citizens.

Those of us who have not enjoyed Sunstein's vantage point within OIRA's war room, so to speak, may well wonder how such a small professional staff could possibly carry out all these functions of gatekeeping, information aggregating, and inter-agency coordination. An important part of the response to that skepticism involves the role played in these procedures by cost-benefit analysis (CBA). Now the use of CBA is one of the few aspects of bureaucracy that many political philosophers have weighed in on – usually weighing in *against* it, on the grounds that it seems inimical to the distributional concerns of justice and a technocratic end-around democracy.⁵⁰ In the space that remains we will try to sketch an argument for why an appropriate framing of the four governance interfaces for democratic theory should make us rethink that standard critique – especially in the case of the regulation of business.

⁴⁹ Ibid: 11-12.

⁵⁰ For significant philosophical critiques of CBA, see: Annette Baier, “Poisoning the Wells,” in Douglas MacLean, ed., *Values at Risk* (Totowa, NJ: Rowman and Allanheld, 1986): 49-74; Mark Sagoff, *The Economy of the Earth* (New York: Cambridge University Press, 1988); Elizabeth Anderson, *Value in Ethics and Economics* (Cambridge, MA: Harvard University Press, 1993): 190-216; Amartya Sen, “The Discipline of Cost-Benefit Analysis,” *Journal of Legal Studies*, 29 (2000): 931-952; Henry Richardson, *Democratic Autonomy*. For a defense of CBA as it is used within public administration which overlaps with ours, and does so in much more detail, see Joseph Heath, *Public Administration and the Liberal State* (University of Toronto, unpublished MS draft September 24, 2014): chapter 5.

There is significant overlap in the critiques of CBA by philosophers cited in the last endnote. They⁵¹ assume that:

- (i) CBA is recommended as a mechanical “technique” or method “for selecting among alternative policies;”
- (ii) CBA is recommended on the assumption that “public policies ought to maximize efficiency;”
- (iii) the method is simply to aggregate costs and benefit on a single dimension, welfare, which is measured using information about “individuals’ revealed preferences” or “compensating variation” or “willingness to pay,” with the result that all relevant costs can be measured in monetary units like dollars; and
- (iv) it ignores information about the distribution of costs and benefits across individuals, or about other costs or benefits that in terms of human values that are incommensurable or cannot be measured or given a price.

With this understanding of what CBA is, the philosophers’ critique then rehearses the standard arguments against direct utilitarianism, which are amplified for these critics by the CBA’s implausible assumption (iii), that well-being can be adequately measured for these purposes in terms of the money actual people would spend to gain a benefit or avoid a cost. If you’re against utilitarianism as a just decision procedure, then you should be even more opposed to CBA; and if you support CBA, it must be because you think, at least in this context, that utilitarianism is a fully justified way of making policy decisions. Or so goes the philosopher’s standard critique.

One general problem with this critique is that (i) and (ii) do not seem to apply to any actually stated mandate by a government, or even any canonical recommendation from law and economics.⁵² It is certainly not the official position in *Executive Order 13563*, or in the British Government’s *Green Book*, or in any of the EU or OECD regulatory-impact assessment protocols we cited earlier. In defense of a contextualized use of CBA, Heath emphasizes that the “first and most important thing to appreciate is that cost-benefit analysis is not literally a decision procedure, which is to say, it is never applied ‘baldly’ to any particular policy question. It is always embedded in a set of more complex institutional decision procedures, which impose a set of constraints that reflect essentially non-utilitarian concerns.”⁵³

But if CBA isn’t literally a decision procedure, what is it actually used for? The answer to this question turns on the crucial distinction, discussed in our critique of the framing assumptions of most contemporary democratic theory in section 4, above, between “democracy as a form of *decision-making*” and “democracy as a form

⁵¹ The quotes and paraphrasing in the following list are from two of the most important of the philosophical critiques of CBA, from the books by Anderson and Richardson cited in the previous note.

⁵² Richardson (*Democratic Autonomy*: 271n4) actually asks “Is there anyone who accords CBA this kind of importance as an underlying standard for policy-making?” He then mentions only a 1981 book by Richard Posner, along with the clarification that “Posner retreats from defending CBA as a decision-making standard and instead insists on the point that I explicitly concede, that CBA is a useful tool of evaluation.”

⁵³ Heath, *Public Administration and the Liberal State*: chapter 5.

of ruling or *governance*.” CBA is an essential tool for those tasked with oversight responsibilities at various “governance interfaces” between citizens and front-line regulators in administrative agencies – especially, in the case of the current US model, for the gatekeepers and information aggregators at OIRA.⁵⁴ Consider three types of regulatory failures you would want to be able to spot from that vantage point: regulations produced by “**captured**” regulators favoring the interests of the industry they are regulating; regulations furthering the “**empire-building**” goals of particular agencies and agency directors (i.e., the classic subject matter of *Yes, Minister*); and regulations that are based on an understanding of impacts that has been compromised by the vulnerability of individual regulators to standard cognitive biases and heuristics – something Cass Sunstein is calling “**epistemic capture**.”⁵⁵ Regulations that are compromised in any of these ways are likely to have flawed analyses of costs and benefits when they land on the desk of the OIRA officer responsible for vetting them. In the case of direct or indirect capture, for example, we might expect to find an overestimate of the costs of various alternative rules to the businesses they will apply to, based in large part on the information prepared by spokespeople from the industry; and also an underestimate of the benefits to other parties (employees, consumers, or third parties who are harmed by the industry’s emissions, say). This is where OIRA could bring other agencies, or outside experts, into the process to give a fuller account of the impact the proposed regulation will have on all parties. Regulations proposed by captured or empire-building agencies are also likely to ignore various alternatives, which the oversight of an office like OIRA can try to generate by promoting public comments and inter-agency discussions. These points apply particularly to governance considerations in the evaluation of proposed *new* or *reformed* regulations. But the governance mandate for those overseeing regulation in a democratic state also includes periodic retrospective evaluation of *existing* regulations (“regulatory-impact assessment” or RIA).⁵⁶ And at this stage CBA becomes a valuable “forensic” tool for identifying regulations crafted by captured agencies. Although it will often be practically difficult to gather all the data, an oversight agency like OIRA has the opportunity to discover when rules have, say, ended up benefiting the regulated industry at the expense of much more substantial costs to others. Section 6 of *Executive Order 13563* requires such periodic reviews, and instructs OIRA to “modify, streamline, expand, or repeal [existing regulations] in accordance with what has been learned.”

In this way, CBA is less a blind technocratic calculation, and more of an organizing device for tracing the sources of information – used, neglected, or distorted – that went into an agency’s case for a new rule. As rarefied as it is, CBA provides a “common language” for regulatory assessment across the very different

⁵⁴ Eric Posner, “Controlling Agencies with Cost-Benefit Analysis: A Positive Political Theory Perspective,” *University of Chicago Law Review* 68 (2001); Renda, *Law and Economics in the RIA World*: 39-40.

⁵⁵ “Even if the officials want to be neutral and are seeking merely to obtain relevant information, their own perspectives might well be shaped by the limited class of people to whom they are listening. From a neutral standpoint, and with all the good will in the world, they might be subject to epistemic capture....” Sunstein, *Valuing Life*: 33. He attributes the term “epistemic capture” to Adrian Vermeule.

⁵⁶ Renda, *Law and Economics in the RIA World*: 146-155.

disciplinary, industrial, and social, cultures of the vastly different administrative agencies that run the modern state. It is well known that individual agencies often push back against the use of this *lingua franca*, preferring instead a richer set of variables for evaluating regulations in their specific domain. But it is also well known in studies of agency problems in complex organizations – including large state-owned corporations and commercial agencies – that when managers and administrators are allowed to define their own standards for success (or in this case, their own metrics for justifying regulations), especially when these permit multiple goals, that it becomes much more difficult for outsiders to evaluate their successes or failures.⁵⁷

In sum, although nothing like CBA will be a “first-best” theory for making and justifying public policy *decisions*, it may be a very useful “second-best” theory within the context of a complex system of democratic governance. It serves a positive function as a prompt for gathering information on how the interests of *all* citizens would be affected by a proposed law, even if many of those voices would not have been heard in public consultations; and it helps elected officials and senior officials in the executive detect *corrupted* regulation, either before it can be enacted or during regular “external audits.” To the extent this is true (and we are certainly not pretending to mount a rigorous defense of CBA here), it can be part of a very complex institutional answer to the prickly Democrat’s Regulatory Dilemma we sketched in section 5. It tells us (in part) how a government and its citizens can get the benefits of “smart” regulation developed through the necessary collaboration of the regulators, the regulated industries, and other interested parties, on the one hand; along with the possibility of securing some degree of independence between the “referees” and the “players,” on the other.

Our main point in this very brief and unsubtle discussion of CBA-within-a-system-of-regulatory-oversight is that this kind of issue deserves a prominent place in the agenda of *democratic theory*: a theory that broadens its focus from a small set of *decision-making* problems to a broad range of *governance* challenges. The horns of the Democrat’s Regulatory Dilemma are both far too sharp for us not to search for a more democratically comfortable platform from which to address the real, concrete challenges of regulatory oversight in a constitutional democracy with a market economy. From here we can also begin to fill out our understanding of the political obligations for citizens and for responsible business actors when they engage with civil servants and elected officials. Among other things, it highlights the importance of an obligation to provide accurate data (and/or to enable others to collect accurate data) on the relevant social costs of production, including negative externalities, under various actual and proposed regulatory standards. To be sure, this obligation is not one we typically see in lists of the beyond-compliance obligations of “socially

⁵⁷ See, e.g., Allen Buchanan, “Toward a Theory of the Ethics of Bureaucratic Organizations,” *Business Ethics Quarterly* 6 (1996): 419-440; Joseph Heath and Wayne Norman, “Stakeholder Theory, Corporate Governance and Public Management,” *Journal of Business Ethics* 53 (2004): 247-265; Andrea Renda, *Law and Economics in the RIA World: Improving the Use of Economic Analysis in Public Policy and Legislation*: 146-155.

responsible corporations.” But if we ask better questions we should expect to see some novel answers.

Our aim here has been merely to sketch the outlines of a case for: (a) the relevance of some *neglected questions* at the intersection of political philosophy, political economy, law and economics, and business ethics once we recognize that democracy and democratic theory are about *governance* and not merely about *decision-making*; and for (b) why some standard simplifying assumptions in theorizing about justice and democracy – say, that we can presume autonomous spheres for the regulated and the regulators, or that most lawmaking is or should be done at the level of legislators accountable to informed citizens – get in the way of potentially promising answers to these questions.