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978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and How to Limit it

Edited by Daniel Carpenter and David A. Moss

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PREVENTING REGULATORY CAPTURE

When regulations (or lack thereof) seem to detract from the common good, critics often point to regulatory capture as a culprit. In some academic and policy circles, it seems to have assumed the status of an immutable law. Yet for all the ink spilled describing and decrying capture, the concept remains difficult to nail down in practice.

Is capture truly as powerful and unpreventable as the informed consensus seems to suggest? This edited volume brings together seventeen scholars from across the social sciences to address this question. Their work shows that capture is often misdiagnosed and may in fact be preventable and manageable. Focusing on the goal of prevention, the volume advances a more rigorous and empirical standard for diagnosing and measuring capture, paving the way for new lines of academic inquiry and more precise and nuanced reform.

Daniel Carpenter is the Allie S. Freed Professor of Government and Director of the Center for American Political Studies in the Faculty of Arts and Sciences at Harvard University. His first book, *The Forging of Bureaucratic Autonomy: Reputations, Networks and Policy Innovation in Executive Agencies, 1862–1928*, was awarded the American Political Science Association's Gladys Kammerer Prize, as well as the Charles Levine Prize of the International Political Science Association. His second book, *Reputation and Power: Organizational Image and Pharmaceutical Regulation at the FDA*, received the 2011 Allan Sharlin Memorial Award from the Social Science History Association.

Professor Carpenter has held fellowships from the John Simon Guggenheim Foundation, the Radcliffe Institute for Advanced Study, the Center for Advanced Study in the Behavioral Sciences, the Brookings Institution, and the Santa Fe Institute. He has received grants from the National Science Foundation, the National Endowment for the Humanities, the Robert Wood Johnson Foundation (Scholars in Health Policy 1998–2000, Investigator Award in Health Policy Research 2004–2007), the Alfred Sloan Foundation, the Russell Sage Foundation, and the Safra Center for Ethics.

David A. Moss is the John G. McLean Professor at Harvard Business School and the President of the Tobin Project, the nonprofit research organization that sponsored this volume. He has published numerous books and articles on economic policy and policy history, including *When All Else Fails: Government as the Ultimate Risk Manager*, which won the American Risk and Insurance Association's Annual Kulp-Wright Book Award for the "most influential text published on the economics of risk management and insurance." Other books include *Socializing Security: Progressive-Era Economists and the Origins of American Social Policy*, *A Concise Guide to Macroeconomics*, and *Government and Markets: Toward a New Theory of Regulation* (Cambridge University Press, 2010, coedited with Edward Balleisen).

Professor Moss is the recipient of numerous honors and awards, including the Robert F. Greenhill Award, the Editors' Prize from the *American Bankruptcy Law Journal*, and the Student Association Faculty Award for outstanding teaching at Harvard Business School.

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Frontmatter

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Frontmatter

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Frontmatter
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Contents

<i>List of Figures</i>	<i>page</i> vii
<i>List of Tables</i>	ix
<i>Editors</i>	xi
<i>Contributors</i>	xiii
<i>Preface</i>	xxiii
<i>Acknowledgments</i>	xxvii
Introduction	1
<i>Daniel Carpenter and David A. Moss</i>	
SECTION I: FAILURES OF CAPTURE SCHOLARSHIP	23
1 A Revisionist History of Regulatory Capture	25
<i>William J. Novak</i>	
2 The Concept of Regulatory Capture: A Short, Inglorious History	49
<i>Richard A. Posner</i>	
3 Detecting and Measuring Capture	57
<i>Daniel Carpenter</i>	
SECTION II: NEW CONCEPTIONS OF CAPTURE – MECHANISMS AND OUTCOMES	69
4 Cultural Capture and the Financial Crisis	71
<i>James Kwak</i>	
5 Complexity, Capacity, and Capture	99
<i>Nolan McCarty</i>	
6 Preventing Economists’ Capture	124
<i>Luigi Zingales</i>	

vi	<i>Contents</i>	
7	Corrosive Capture? The Dueling Forces of Autonomy and Industry Influence in FDA Pharmaceutical Regulation <i>Daniel Carpenter</i>	152
	SECTION III: REGULATORY CASE STUDIES	173
8	Capturing History: The Case of the Federal Radio Commission in 1927 <i>David A. Moss and Jonathan B. L. Decker</i>	176
9	Conditional Forbearance as an Alternative to Capture: Evidence From Coal Mine Safety Regulation <i>Sanford C. Gordon and Catherine Hafer</i>	208
10	Captured by Disaster? Reinterpreting Regulatory Behavior in the Shadow of the Gulf Oil Spill <i>Christopher Carrigan</i>	239
11	Reconsidering Agency Capture During Regulatory Policymaking <i>Susan Webb Yackee</i>	292
12	Coalitions, Autonomy, and Regulatory Bargains in Public Health Law <i>Mariano-Florentino Cuéllar</i>	326
	SECTION IV: THE POSSIBILITY OF PREVENTING CAPTURE	363
13	Preventing Capture Through Consumer Empowerment Programs: Some Evidence from Insurance Regulation <i>Daniel Schwarcz</i>	365
14	Courts and Regulatory Capture <i>M. Elizabeth Magill</i>	397
15	Can Executive Review Help Prevent Capture? <i>Michael A. Livermore and Richard L. Revesz</i>	420
	Conclusion: A Focus on Evidence and Prevention <i>David A. Moss and Daniel Carpenter</i>	451
	Afterword <i>Senator Sheldon Whitehouse and Jim Leach</i>	467
	Index	475

List of Figures

5.1	Regulatory Outcomes	<i>page</i> 107
5.2	The Complex Policy Model	109
5.3	Policy Outcomes with Proximity Learning Effect	115
9.1	Miner Deaths Per 10,000 Full-Time Equivalent Workers, 1931–2008	214
9.2	Equilibrium in the Regulatory Enforcement Game and the Identification Problem	222
9.3	U.S. Newspaper and Wire Stories Mentioning the Mine Safety and Health Administration, by Month, 1999–2010	228
9.4	The Effect of the Jim Walter Resources No. 5 Mine Disaster on MSHA Enforcement: Interrupted Time Series Analysis	230
9.5	The Effect of the Sago Mine Disaster on MSHA Enforcement: Interrupted Time Series Analysis	232
9.6	The Effect of the Crandall Canyon Mine Disaster on MSHA Enforcement: Interrupted Time Series Analysis	233
9.7	The Effect of the Upper Big Branch Mine Disaster on MSHA Enforcement: Interrupted Time Series Analysis	235
10.1	MMS’s Offshore Energy and Revenue Management Funding Levels (1983–2009)	262
10.2	Average Water Depth of Oil and Gas Production in the Gulf of Mexico (January 1990–December 2002)	273
10.3	Percent of Total 1965–2009 OCS Barrels Spilled and Oil Produced in Successive Three Year Periods	277
10.4	Gallup Opinion Poll Results Measuring Preference for Environmental Protection or Economic Growth (1984–2010)	281
11.1	Participation Across Rulemaking Stages and Lobbying Forms	310
11.2	Perceived Comment Success	318
11.3	Big Business and Corporations Advantage During Rulemaking	319
11.4	Influence Factors on State Rules and Regulations	321

Cambridge University Press

978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and
How to Limit it

Edited by Daniel Carpenter and David A. Moss

Frontmatter

[More information](#)

List of Tables

3.1	A. The case of statutory capture	<i>page</i> 59
3.2	B. The case of agency capture	60
5.1	Payoffs and regulatory outcomes	112
6.1	Variables’ description	134
6.2	Summary statistics	135
6.3	Probusiness and not probusiness content in different journals	136
6.4	Citations as a function of content	137
6.5	Content as a function of type of job of the authors	140
7.1	Probit analyses of three votes on S. 5	159
7.2	Duration regressions for new molecular entities, 1979–2000	167
7.3	Duration regressions for new molecular entities, 1979–2000: analysis of foreign versus domestic firm effects	169
9.1	Summary statistics for measures employed in the analysis	227
10.1	Percentage of MMS employees by category in Colorado and Louisiana in September 2008	253
10.2	Subject matter of congressional hearings in which MMS personnel testified by function (1982–2009)	259
10.3	MMS relative budget changes and revenue management appearances before the House Committee on Oversight and Government Reform (1984–2009)	264
10.4	MMS relative budget changes before and after the congressional decision to allow use of revenue receipts (1984–2009)	266
10.5	Summary of important statutes enacted pertaining to offshore energy or revenue management (1982–2010)	279
11.1	Author’s sample rules drawn from U.S. DOT	307
11.2	Commenter influence across rule stages	314
11.3	Correlations across rule stages	316
13.1	OPIC’s recent activities	374

Cambridge University Press
978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and
How to Limit it
Edited by Daniel Carpenter and David A. Moss
Frontmatter
[More information](#)

x	<i>List of Tables</i>	
13.2	Historical experience of CPPP	378
13.3	Rate proceedings in which compensation was awarded, 2009–2010	379
13.4	Summary of consumer empowerment programs in insurance	388
13.5	Summary of tentative thoughts on consumer empowerment programs	389

Cambridge University Press

978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and How to Limit it

Edited by Daniel Carpenter and David A. Moss

Frontmatter

[More information](#)

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Daniel Carpenter is Allie S. Freed Professor of Government and Director of the Center for American Political Studies in the Faculty of Arts and Sciences at Harvard University. For the 2011–2012 academic year, he was a Walter Channing Cabot Faculty Fellow at Harvard and a visiting researcher at the Institut d'Études Politiques at the Université de Strasbourg in France. He graduated from Georgetown University in 1989 with distinction in Honors Government and received his doctorate in political science from the University of Chicago in 1996. He taught previously at Princeton University (1995–1998) and the University of Michigan (1998–2002). He joined the Harvard University faculty in 2002. Dr. Carpenter mixes theoretical, historical, statistical, and mathematical analyses to examine the development of political institutions, particularly in the United States. He focuses on public bureaucracies and government regulation, particularly regulation of health and financial products. His dissertation received the 1998 Harold D. Lasswell Award from the American Political Science Association (APSA) and as a book – *The Forging of Bureaucratic Autonomy: Reputations, Networks and Policy Innovation in Executive Agencies, 1862–1928* (Princeton: Princeton University Press, 2001) – was awarded the APSA's Gladys Kammerer Prize as well as the Charles Levine Prize of the International Political Science Association. His recently published book on pharmaceutical regulation in the United States, *Reputation and Power: Organizational Image and Pharmaceutical Regulation at the FDA* (Princeton: Princeton University Press, 2010), has received the 2011 Allan Sharlin Memorial Award from the Social Science History Association.

Professor Carpenter has held fellowships from the John Simon Guggenheim Foundation, the Radcliffe Institute for Advanced Study, the Center for Advanced Study in the Behavioral Sciences, the Brookings Institution, and the Santa Fe Institute. He has received grants from the National Endowment for the Humanities, the National Science Foundation, the Robert Wood

Cambridge University Press

978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and How to Limit it

Edited by Daniel Carpenter and David A. Moss

Frontmatter

[More information](#)

xii

Editors

Johnson Foundation (Scholars in Health Policy 1998–2000, Investigator Award in Health Policy Research 2004–2007), the Alfred Sloan Foundation, the Russell Sage Foundation, and the Safra Center for Ethics. In the past few years, Professor Carpenter has been the winner of both the 2011 Herbert Simon Award of the Midwest Political Science Association for a scholar “who has made a significant career contribution to the scientific study of bureaucracy,” as well as the 2011 David Collier Award of the American Political Science Association for career contributions to qualitative and multimethod research.

David A. Moss is the John G. McLean Professor at Harvard Business School, where he teaches in the Business, Government, and the International Economy (BGIE) unit. He earned his BA from Cornell University and his PhD from Yale. In 1992–1993, he served as a senior economist at Abt Associates. He joined the Harvard Business School faculty in July 1993. Professor Moss’s research focuses on economic policy, especially the government’s role as a risk manager. He has published three books on these subjects: *Socializing Security: Progressive-Era Economists and the Origins of American Social Policy* (Harvard University Press, 1996), which traces the intellectual and institutional origins of the American welfare state; *When All Else Fails: Government as the Ultimate Risk Manager* (Harvard University Press, 2002), which explores the government’s pivotal role as a risk manager in policies ranging from limited liability law to federal disaster relief; and *A Concise Guide to Macroeconomics: What Managers, Executives, and Students Need to Know* (Harvard Business School Press, 2007), a primer on macroeconomics and macroeconomic policy. In addition to these books, Moss has coedited two volumes on economic regulation and has published numerous articles, book chapters, and case studies, mainly in the fields of institutional and policy history, financial history, political economy, and regulation. One recent article, “An Ounce of Prevention: Financial Regulation, Moral Hazard, and the End of ‘Too Big to Fail’” (*Harvard Magazine*, September–October 2009), grew out of his research on financial regulation for the TARP Congressional Oversight Panel.

Professor Moss is the founder of the Tobin Project, a nonprofit research organization, and a member of the National Academy of Social Insurance. Recent honors include the Robert F. Greenhill Award, the Editors’ Prize from the *American Bankruptcy Law Journal*, the Student Association Faculty Award for outstanding teaching at the Harvard Business School (seven times), and the American Risk and Insurance Association’s Annual Kulp-Wright Book Award for the “most influential text published on the economics of risk management and insurance.”

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Frontmatter

[More information](#)

Contributors

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Frontmatter

[More information](#)

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Sanford C. Gordon is Associate Professor of Politics at New York University. He received his BA from Cornell and his PhD from Princeton. Prior to his arrival at NYU, Professor Gordon taught at the Ohio State University from 1999–2002, and in 2005–2006, he was a Fellow-in-Residence at the Center for the Study of Democratic Politics at Princeton. Professor Gordon's work – spanning interest group influence in administrative and legislative politics, bureaucratic politicization, the political economy of criminal justice, and research methodology – has appeared in the *American Political Science Review*; the *American Journal of Political Science*; the *Journal of Politics*; the *Quarterly Journal of Political Science*; *Political Analysis*; the *Journal of Law*,

Cambridge University Press

978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and How to Limit it

Edited by Daniel Carpenter and David A. Moss

Frontmatter

[More information](#)

Contributors

xv

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James Kwak joined the faculty at the University of Connecticut School of Law in 2011 as an Associate Professor of Law. He has a wide range of interests, including business organizations, corporate governance, financial markets and regulation, and fiscal policy. He is an online columnist for *The Atlantic* and coauthor of *The Baseline Scenario*, a leading blog covering economics and public policy. His articles have appeared in many publications, including *Democracy*, *The American Prospect*, *The New York Times*, *The Washington Post*, and *The Los Angeles Times* and on the Web sites of *The Wall Street Journal*, *The Huffington Post*, NPR, *Foreign Policy*, and *The Financial Times*. He coauthored *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown*, a 2010 *New York Times* bestseller chronicling the rise of the financial sector over the past three decades, and *White House Burning: The Founding Fathers, Our National Debt, and Why It Matters to You*, a *Wall Street Journal* business bestseller analyzing the history and politics of deficits and the national debt. Before going to law school, he worked as a management consultant at McKinsey and Company and cofounded Guidewire Software, a leading provider of core systems to property and casualty insurance companies. He lives in Amherst, Massachusetts, with his wife and two children.

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978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and How to Limit it

Edited by Daniel Carpenter and David A. Moss

Frontmatter

[More information](#)

xvi

Contributors

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M. Elizabeth Magill was appointed the Richard E. Lang Professor of Law and Dean of Stanford Law School on September 1, 2012. She is the law school's thirteenth dean. Before coming to Stanford, she was on the faculty at the University of Virginia School of Law for fifteen years, serving most recently as vice dean, the Joseph Weintraub–Bank of America Distinguished Professor of Law, and the Elizabeth D. and Richard A. Merrill Professor. An expert in administrative law and constitutional structure, Dean Magill teaches administrative law, constitutional law, and food and drug law. Her scholarly articles have been published in leading law reviews, and she has won several awards for her scholarly contributions. She is a member of the American Law Institute and served as a Fellow in the Program in Law and Public Affairs at Princeton University; a visiting professor at Harvard Law School; and the Thomas Jefferson Visiting Fellow at Downing College, Cambridge University. After completing her BA in history at Yale University in 1988, Dean Magill served as a senior legislative assistant for energy and natural resources for U.S. Senator Kent Conrad, a position she held for four years. She left the Hill to attend the University of Virginia School of Law, where she was articles development editor of the *Virginia Law Review* and received several awards for academic and scholarly achievement. After graduating in 1995, Dean Magill clerked for Judge J. Harvie Wilkinson III of the U.S. Court of Appeals for the Fourth Circuit and then for U.S. Supreme Court Justice Ruth Bader Ginsburg.

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978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and How to Limit it

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Frontmatter

[More information](#)

Contributors

xvii

International Affairs. His research interests include U.S. politics, democratic political institutions, and political game theory. He is the coauthor of two books: *Political Game Theory* (2006, Cambridge University Press with Adam Meirowitz) and *Polarized America: The Dance of Ideology and Unequal Riches* (2006, MIT Press with Keith Poole and Howard Rosenthal). Other recent publications include *The Realignment of National Politics and the Income Distribution* (1997 with Keith Poole and Howard Rosenthal); “Does Gerrymandering Cause Polarization” (2009 with Keith Poole and Howard Rosenthal) in the *American Journal of Political Science*; “Presidential Vetoes in the Early Republic” (2004) in *Journal of Politics*; “Bureaucratic Capacity, Delegation, and Political Reform” (2004 with John Huber) in the *American Political Science Review*; “The Appointments Dilemma” (2004) in the *American Journal of Political Science*; “Political Resource Allocation: The Benefits and Costs of Voter Initiatives” (2001 with John G. Matsusaka) in the *Journal of Law, Economics, and Organization*; “The Hunt for Party Discipline” (2001 with Keith Poole and Howard Rosenthal) in the *American Political Science Review*; “Cabinet Decision Rules and Political Uncertainty in Parliamentary Bargaining” (2001 with John Huber) in the *American Political Science Review*; and “The Politics of Blame: Bargaining Before an Audience” (2000 with Timothy Groseclose) in the *American Journal of Political Science*. McCarty was the program cochair of the 2005 Midwest Political Association meetings and was a Fellow at the Center for Advanced Study in the Behavioral Sciences during the 2004–2005 academic year. During the 2007–2008 academic year, he was the acting dean of the Woodrow Wilson School. In 2010, he was elected a Fellow of the American Academy of Arts and Sciences. He blogs about American politics at <http://www.nolanmccarty.com>.

William J. Novak, an award-winning legal scholar and historian, joined the University of Michigan Law School faculty in fall 2009. Professor Novak came from the University of Chicago, where he had been an associate professor of history; a founding member of the university’s Human Rights Program and Law, Letters, and Society Program; and director of its Center for Comparative Legal History. Since 2000, Novak has been a research professor at the American Bar Foundation. In 1996, he published *The People’s Welfare: Law and Regulation in Nineteenth-Century America*, which won the American Historical Association’s Littleton-Griswold Prize and was named Best Book in the History of Law and Society. A specialist on the legal, political, and intellectual history of the United States, Professor Novak earned his PhD in the history of American civilization from Brandeis University in 1991. He was a visiting faculty member at Michigan Law during fall 2007, when he taught courses in U.S. legal history and legislation. Professor Novak

Cambridge University Press

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Frontmatter

[More information](#)

xviii

Contributors

is currently at work on *The People's Government: Law and the Creation of the Modern American State*, a study of the transformation in American liberal governance around the turn of the twentieth century.

Judge Richard A. Posner clerked for Justice William F. Brennan Jr. following his graduation from Harvard Law School. From 1963 to 1965, he was assistant to Commissioner Philip Elman of the Federal Trade Commission. For the next two years he was assistant to the Solicitor General of the United States. Prior to going to Stanford Law School in 1968 as Associate Professor, Judge Posner served as general counsel of the President's Task Force on Communications Policy. He first came to the University of Chicago Law School in 1969 and was Lee and Brena Freeman Professor of Law prior to his appointment in 1981 as a judge of the U.S. Court of Appeals for the Seventh Circuit. He was the chief judge of the court from 1993 to 2000. Judge Posner has written a number of books, including *Economic Analysis of Law* (8th ed., 2011); *The Economics of Justice* (1981); *Law and Literature* (3rd ed., 2009); *The Problems of Jurisprudence* (1990); *Cardozo: A Study in Reputation* (1990); *The Essential Holmes* (1992); *Sex and Reason* (1992); *Overcoming Law* (1995); *The Federal Courts: Challenge and Reform* (1996); *Law and Legal Theory in England and America* (1996); *The Problematics of Moral and Legal Theory* (1999); *Antitrust Law* (2nd ed., 2001); *Law, Pragmatism, and Democracy* (2003); *Catastrophe: Risk and Response* (2004); *Preventing Surprise Attacks: Intelligence Reform in the Wake of 9/11* (2005); *How Judges Think* (2008); *A Failure of Capitalism: The Crisis of '08 and the Descent into Depression* (2009); and *The Crisis of Capitalist Democracy* (2010), as well as books on the Clinton impeachment and *Bush v. Gore* and many articles in legal and economic journals and book reviews in the popular press. He has taught administrative law, antitrust, economic analysis of law, history of legal thought, conflict of laws, regulated industries, law and literature, the legislative process, family law, primitive law, torts, civil procedure, evidence, health law and economics, law and science, and jurisprudence. He was the founding editor of the *Journal of Legal Studies* and (with Orley Ashenfelter) the *American Law and Economics Review*. He is an Honorary Bencher of the Inner Temple and a Corresponding Fellow of the British Academy, and he was the President of the American Law and Economics Association from 1995 to 1996 and the honorary President of the Bentham Club of University College London for 1998. He has received honorary degrees from leading American and foreign universities, along with a number of awards, including the Thomas Jefferson Memorial Foundation Award in Law from the University of Virginia in 1994, the Marshall-Wythe Medallion

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Frontmatter

[More information](#)

Contributors

xix

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Cambridge University Press

978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and How to Limit it

Edited by Daniel Carpenter and David A. Moss

Frontmatter

[More information](#)

xx

Contributors

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Susan Webb Yackee is an Associate Professor of Public Affairs and Political Science. Her research and teaching interests include regulation, administrative law, interest groups, bureaucratic politics, and the policymaking process. Her work has been published in the *Journal of Politics*, *George Washington Law Review*, *Journal of Public Administration Research and Theory*, *British Journal of Political Science*, *Journal of Policy Analysis and Management*, *American Politics Research*, *Political Research Quarterly*, and *Policy Studies Journal*. Yackee won the 2008 Paul Volcker Endowment Junior Scholar Research Award from the American Political Science Association's Public Administration Section. She also received APSA's 2007 "Emerging Scholar Award" from its Political Parties and Organizations Section, and the Midwest Political Science Association honored her with the "Best Paper by an Emerging Scholar" Award in 2008. In 2010, she received a poster session award for "Excellent Research by New and Emerging Scholars" from the Association for Public Policy Analysis and Management. From 2003 to 2005, Dr. Yackee was a Robert Wood Johnson Foundation Scholar in Health Policy Research at the University of Michigan in Ann Arbor. She has

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978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and How to Limit it

Edited by Daniel Carpenter and David A. Moss

Frontmatter

[More information](#)

Contributors

xxi

served as a Smith Richardson Domestic Policy Fellow, a UW-Madison Vilas Associate Professor, and a Harry S. Truman Scholar. Before beginning her academic training, she worked as a legislative research assistant in the U.S. Senate.

Luigi Zingales joined the Chicago Booth faculty in 1992. His research interests range from corporate governance to financial development, from political economy to the economic effects of culture. Currently, he is involved in developing the best interventions to cope with the aftermath of the financial crisis. He also codeveloped the Financial Trust Index, which is designed to monitor the level of trust that Americans have toward their financial system. In addition to holding his position at Chicago Booth, Zingales is currently a Faculty Research Fellow for the National Bureau of Economic Research, a Research Fellow for the Center for Economic Policy Research, and a Fellow of the European Governance Institute. He is also the director of the American Finance Association and an editorialist for *Il Sole 24 Ore*, the Italian equivalent of the *Financial Times*. Zingales also serves on the Committee on Capital Markets Regulation, which has been examining the legislative, regulatory, and legal issues affecting how public companies function. His research has earned him the 2003 Bernácer Prize for the best young European financial economist, the 2002 NASDAQ award for best paper in capital formation, and a National Science Foundation grant in economics. His work has been published in the *Journal of Financial Economics*, the *Journal of Finance*, and the *American Economic Review*. Zingales received a bachelor's degree in economics *summa cum laude* from Università Bocconi in Italy in 1987 and a PhD in economics from the Massachusetts Institute of Technology in 1992. In addition to teaching and researching, Zingales enjoys cooking and spending time with his children.

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978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and
How to Limit it

Edited by Daniel Carpenter and David A. Moss

Frontmatter

[More information](#)

Cambridge University Press

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Edited by Daniel Carpenter and David A. Moss

Frontmatter

[More information](#)

Preface

In the wake of the global financial crisis of 2007–2009 and the Deep Water Horizon Oil Spill of 2010, regulatory capture has become at once a diagnosis and a source of discomfort. The word *capture* has been used by dozens upon dozens of authors – ranging from pundits and bloggers to journalists and leading scholars – as the telltale characterization of the regulatory failures that permitted these crises. In addition, critics who doubt whether regulatory reforms will be sufficient draw on capture as a source of widespread skepticism (if not despair). Seen this way, capture of regulation appears not only as a significant cause of these crises, but also as a constraint on any realistic solutions. Most of those solutions will, in this view, be watered down or dashed by captured regulators in the future.

Is capture truly as powerful and unpreventable as the informed consensus seems to suggest? When it prevails, does capture pose insurmountable obstacles to regulation, so much so that we ought to give up on regulation altogether? This edited volume brings together seventeen scholars from across disciplines whose contributions together question this logic and suggest that capture may, in fact, be preventable and manageable.

The volume is part of a broader project to re-imagine regulatory scholarship. In early 2008, a group of social scientists convened to consider the state of scholarship on regulation as part of a research initiative organized by the Tobin Project, an independent and nonprofit research organization based in Cambridge, Massachusetts. Although research on government failure had come a long way since the mid-twentieth century, scholarship on what distinguishes government success from failure had been less robust. It was as if medical researchers had spent decades identifying cases of medical error, without offering a complementary understanding of how (and when) doctors intervened successfully to improve patients' lives. A new focus was needed to better understand not only cases in which government failed,

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978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and How to Limit it

Edited by Daniel Carpenter and David A. Moss

Frontmatter

[More information](#)

xxiv

Preface

but also cases in which government succeeded, and the conditions under which each occurred. In 2010, this research effort produced a first edited volume – *Government & Markets: Toward a New Theory of Regulation* (eds. E. Balleisen & D. Moss, Cambridge University Press) – which explored both the promises and pitfalls of regulation and ultimately aimed to identify strategies for improving regulatory governance.

The financial crisis of 2007–2009 gave palpable urgency to this ongoing research initiative. As financial regulatory reform took center stage in Washington, D.C., policymakers were faced with a great range of complex issues, tasked with addressing the risks and benefits inherent in everything from derivatives markets to systemically significant financial institutions. To get up to speed on such highly specialized subjects, legislators and their staffs often turned to outside experts for input. At various points during the regulatory reform process, scholars involved in the Tobin Project's research efforts were asked to share their perspectives on the problems of financial regulation and to give advice on potential solutions.

As these conversations progressed, preventing capture emerged as an important issue for policymakers. Throughout 2009 and 2010, both the House of Representatives and the Senate were considering bills that would establish a new agency with independent authority to protect retail consumers of financial products, an idea initially developed by Professor (now Senator) Elizabeth Warren¹ and ultimately instituted as the new Consumer Financial Protection Bureau. At the same time, both houses of Congress were exploring options for how to manage systemic risk throughout the financial system, proposals that ultimately gave rise to the Financial Stability Oversight Council. With respect to both efforts, the question arose repeatedly: Was it possible to design agencies in ways that would protect or insulate them from capture?

In 2009, the Tobin Project convened many of our country's leading experts on regulation to take up this question of how to prevent regulatory capture. The inquiry quickly gained traction, and this volume is one of the products of that effort. In line with the mission of the Tobin Project, the chapters that follow aim to deepen our understanding of a truly important and consequential problem facing the nation. The Tobin Project is grateful to the authors who have contributed to this inquiry and hopeful that the

¹ See Elizabeth Warren. "Unsafe at Any Rate." *Democracy: A Journal of Ideas* 5 (2007): 8–19 (based on a working paper originally written for and presented at a 2007 Tobin Project working group meeting on risk policy).

Cambridge University Press

978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and
How to Limit it

Edited by Daniel Carpenter and David A. Moss

Frontmatter

[More information](#)

Preface

xxv

volume will prove informative to scholars and policymakers alike and will
inspire further rounds of research on regulatory capture – and how to
prevent it – in the years ahead.

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Cambridge University Press

978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and
How to Limit it

Edited by Daniel Carpenter and David A. Moss

Frontmatter

[More information](#)

Cambridge University Press

978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and How to Limit it

Edited by Daniel Carpenter and David A. Moss

Frontmatter

[More information](#)

Acknowledgments

This volume is the product of an ongoing process of collaboration and exchange at the Tobin Project, sustained by the energy, talents, and resources of numerous individuals.

We would first like to thank Steven Croley, of the University of Michigan Law School, for his vital input when the ideas for this project were still crystallizing, and Mitchell Weiss, the first executive director of the Tobin Project, who helped conceive of – and launch – the “preventing capture” effort. We are also deeply indebted to John Cisternino, the Tobin Project’s Director of Research, who has played a large role in sparring over core ideas and moving the project forward, along with Melanie Wachtell Stinnett, the Tobin Project’s Director of Policy and Communications.

From the genesis of the idea for this volume until the last round of revisions, and at every step in between, the tireless work of the Tobin staff has been simply invaluable, both intellectually and administratively. In addition to those already named, we would especially like to recognize Katie Nihill, Tim Lambert, Yousef Gharbieh, and Sage Trombulak for their outstanding contributions to the volume.

Many of the main ideas animating our research agenda on regulation originated during discussions with policymakers, whose work this volume aspires to illuminate and assist. We would like to thank all of those members of Congress and the administration who participated in a productive roundtable discussion on regulatory capture in the fall of 2011. We are also grateful to Senator Sheldon Whitehouse for his ongoing engagement with this project since 2011, and to Senator Whitehouse and Jim Leach, Chair of the National Endowment for the Humanities, for contributing the Afterword. Senator Whitehouse’s staff members, including Steven Lilley and Ayo Griffin, have been instrumental in helping to facilitate and shape the

Cambridge University Press
978-1-107-03608-6 - Preventing Regulatory Capture: Special Interest Influence and
How to Limit it
Edited by Daniel Carpenter and David A. Moss
Frontmatter
[More information](#)

xxviii

Acknowledgments

Afterword, and we are very much indebted to them for all of the superb work they put into this project.

At Cambridge University Press, Scott Parris and Kristin Purdy have been outstanding editors and intellectual partners, and we wish to thank both of them for their guidance, attentiveness, and patience. We are grateful as well to the anonymous reviewers of the manuscript, who devoted much time and energy to working through the draft chapters and offered excellent advice. We also would like to express our appreciation to the Center for American Political Studies at Harvard University, and its Assistant Director Lilia Halpern-Smith, which graciously hosted one of our early workshops on the volume.

Finally, none of this would have been possible without the committed leadership of the Tobin Project's Board of Directors, and the generosity of its financial supporters. Stephanie Khurana, current board member and former interim executive director of the Tobin Project, merits particular recognition for her exceptional guidance and support all along the way.