Regulatory agencies: some theoretical concerns on their creation

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1. Introduction

Institutional analysis has again (and for some years now) become as a major focus of attention to political scientists, together with the consequences of such institutions for the social, economic and certainly political realms (Thelen and Steinmo 1992). However the issue of how institutions emerge and how they change has been somehow neglected, or when they do emerge they claim to explain the institution’s origin by simply making reference to its functions (Knight and Sened 1998; Pierson 2000).

This leads the analyst with the “standard problem of functionalist analysis: that the factors linking the system and its associated functions to actual policies remain unspecified (Hall 1986: 7).

The overall purpose of this paper is to review some of the theoretical approaches that try to explain the creation of regulatory institutions. Most theories may be roughly encapsulated into two large groups: interest theories and institutional theories. The former is based on the assumption that those seeking to regulate do so in order to satisfy their interest, whereas the latter centre their notion of regulation as being shaped by institutional structures and other processes.

Basically the paper will be structured in terms of the distinction of Rational Choice and historical institutionalism, letting it clear that there are “intermediate theoretical stances”. Important to say however that the paper does not intend to pick one of these approaches, nor any of their sub fields, and elect it as the best with disregard for its weaknesses as well as the strengths of the others. The theoretical concern will be analysed in terms of the creation of a particular institution that appeared in Brazil in the late 1990’s: public utility regulatory agencies. These institutions represent a critical moment for the Brazilian state not only in terms of a change in the administrative praxis but also as an alteration in the balance of power of the several groups involved.

The remainder of the paper is structured as follows. The second section briefly describes the historical perspective of regulation. The third section discusses the fundamentals for regulation, including its shortcomings. The fourth section examines the major theoretical views that have dominated the debate in political science to understand the emergence of regulatory organs and how they help in the understanding of the formation of the Brazilian agencies. The conclusion ensues.

2. Historical perspective

Regulation can be very broadly identified with a “sustained and focused control exercised by a public agency over activities that are valued by a community” (Selznick 1985). Others suggest that regulation ought also to be regarded either as a specific set of imperative commands, for example on health and safety; as deliberate state influence, such as taxation and subsidies, and finally as all forms of social control or influence (Baldwin and Cave 1999; Baldwin et al., 1998; Sappington and Stiglitz 1987; Meier 1985). In the first case, regulation is in its simplest form and relates to the enactment of a set of rules together with the mechanisms to enforce them. Such commands are grounded on social or economic aspects, such as the protection of consumers in terms of quality of foodstuff for example, or the citizens in general in relation to negative externalities of industrial production like pollution.

Regulation as deliberate state influence is generally linked to the provision of services and goods by the

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state itself (state owned enterprises are a good example of this) or by the state creating favourable conditions for the private entrepreneurs that allow this provision of services and goods to happen.

Regulation, particularly in the United States, refers classically to government efforts to control prices, output or product quality, on goods and services provided by private firms that otherwise would take unsatisfactory account of the ‘public interest’ (Breyer 1990, his emphasis; Francis 1993: 2), whereas in Western Europe regulation encompassed not only the notion above but also the provision of goods and services by the states. Regulation can also be seen as a process by which order is accomplished (or at least desired) in a sector or sectors in the social and economic realms that display a propensity for disorder that deserves attention (Clarke 2000). By disorder one can claim the suboptimal outcomes that would happen without the regulation or again the unsatisfactory account of the public interest. Clarke also defines regulation as a way of “ordering involving the constitution of a form of authority in order to achieve the practical management of competing interests (ibid.: 5).

Other scholars confine the meaning of regulation to economic matters, where regulatory policy works by influencing the private sector within a system of two non-mutually excluding subsystems: incentives to foster economic decisions (green regulation) and disincentives to constrain economic decisions (red regulation), mainly in the areas of market failures such as natural monopolies or externalities (Vickers and Yarrow 1989, for the coloured regulation, Baldwin and Cave op. cit.).

It may have seemed so far that regulation is an old concept, at least as old as governments themselves (Baldwin and Cave 1999; Baldwin 1998; Majone 1996; Bernstein 1955), and second is that regulation can signify all sorts of intervention, public or private, in both public and private realms. Both statements need clarification.

In fact if one understands regulation as any set of rules enacted by states or by any form of legitimate or illegitimate, private or public authority, to organize society, then regulation is indeed as old as society itself. The primitive societies established norms to be followed by all members of the group (or at least most of them) as well as sanctions to be applied in case of transgression. The old Latin maxim “ubi societas ibi ius” clearly summarises this: where there is society, there is law. However, the tendency to categorize regulation as legislation, governance and social control and the wide use these terms can acquire had led Majone affirm and criticise that the study of regulation coexists with law, economics, political science and sociology, “thus impeding the development of a separate theory on the issue as a distinct kind of policy-making” (Majone 1996).

The best suited definition of regulation for this work will be the same adopted by Baldwin (Baldwin et al, 1998: 3) as follows: “the promulgation of a set of rules, accompanied by some mechanism, typically a public agency, for monitoring and promoting compliance with those rules”, also known as ‘American style of regulation’ (Majone 1996). However, the concept will be somewhat narrowed to include exclusively the set of rules for controlling the provision of services and goods characterized as public utilities. It thus incorporates the North American rate of return control (in simple words, scrutinizing the costs and profits of the firms) but circumvent it to the public utilities realm similar to the Western European vision.

As for the time span, regulation will be understood as the practice of monitoring and control adopted as early as 1930’s in the United States with the creation of the regulatory commissions on commerce and trade and at a later stage on environment and food and drug standards (FTC Federal Trade Commission, EPA Environmental Protection Agency, FDA Food and Drug Administration).

3. Fundamentals of Regulation

One of the questions that may strike people is why regulation comes about in the first place. Why not leave the private agents in the economy, producers and consumers, decide which best way to
handle their transactions? The immediate answer to this is that there are imperfections in the market place. These imperfections may lead to sub optimal economic outcomes where the economic processes cannot be fully and most efficiently used. The classical microeconomic assumptions of a perfect market place are that there is widespread, publicized information on prices and quality of the products for sale available for the consumers, and that there is a large number of sellers and buyers (Viscusi et al. 2000). Moreover for there to be a perfect competitive environment, the exchange of goods are costless, the consumption of one individual does not affect the consumption of others (externalities), and the goods are not common (Meier 1985).

Not surprisingly the real world infirms these assumptions. Information is not a free commodity, both in terms of access to it and opportunity to digest and understand technical pieces of it. Firms may acquire a prominent role in the market and become the sole supplier of a specific good or service. Negative by-products may be inherent to the production process, the account of which in the cost is not considered. All this market imperfections are considered in more details below.

**Monopolies**

Monopolies are the archetype example of market imperfection (Baldwin and Cave 1999; Breyer 1990; Francis 1993; Prosser 1989; Helm and Jenkinson 1997; Manzetti 2000; Mayer 2001). Monopolistic situations may occur in three major circumstances: when there is just one seller in the market place, when the product for sale is the only one of its kind and its uniqueness makes it irreplaceable by a substitute, or even when there are sizeable and significant barriers restricting the entry of competing firms in supplying the service or good, and in this latter case the monopoly is characterized as being natural. The utilities industry is a good example of a natural monopoly. Take water and sewage as an illustration. Due to the huge costs of building the infrastructure to collect, clean, store, distribute and commercialise water, it is economically viable to build just one of such network. This leads to natural economies of scale and scope that makes it cheaper for just one firm to provide the service than two or more.

Behind the notion of market inadequacies lies what has become to be known as the fundamental theory of welfare economics. The theorem states that competitive markets lead to an efficient distribution of resources where someone can be made better off without at the same time making someone else worse off. This situation is said to be Pareto-optimal (Viscusi et al. 2000).

The absence of competition in a monopoly industry induces the private agent to decrease production and increase prices above costs of production. In this case there is an unfair redistribution of rent from consumers to producers and also there is production loss where the value for consumers is higher than its production cost plus a reasonable rate of return (Santos 1990). Therefore the purpose of regulation is to attempt to create surrogates for a perfectly competitive market, either temporarily (to allow entry) or permanently (in the case of natural monopolies). Even though competition and regulation may be often regarded as substitutes where the aphorism *competition where possible, regulation where necessary* is valid (Kay and Vickers 1990: 224), in many occasions regulation in enforced not as a substitute for but as a guarantee to a competitive market. This is the case of a strong firm in the market place forcing prices artificially down for some time, making the existence of smaller and weaker firms unviable. After the latter go bankrupt or merge with the former, the leader firm controls all the market and the situation fall in the case described above of reduction of production and increase in prices.

**Information asymmetries**

Information asymmetries represent as well an example of market imperfection that demands correction. The issue goes beyond the knowledge on the fairness of prices according to the cost of production and a fair rate of return. After many less severe cases of ineffective medicines to cases of poisoning and death because of rotten food, the United States first regulation provisions were
concerned with the safety standards and labelling requirements for drugs and foodstuff. The government mandated the supplying firms to test their products and release the information to the consumers, since they did not possess the abilities to evaluate the goodness of the drugs and food themselves. These regulatory provisions represent the first legislation on the consumer protection.3

In many occasions the consumers simply do not know the real cost of a certain product or service to assess whether or not the price being asked is “fair”. This may happen because the companies do not release their cost spreadsheets for strategic reasons. On the other hand, even assuming that the price asked were fair, the risk of not correctly assessing the putative quality of the good or service would remain.

Nowadays the situation seems far more complicated. The increasing complexity and sophistication of products and production processes not rarely go beyond the capacity of consumers to fully assess the consequences of their choice. Moreover, even assuming that information could be understood, there would remain the issue of the cost to produce it, both in terms of acquiring it and allocating time to analyse it in detriment of other productive activities. On the other hand the incentives to produce information by the suppliers of the service or good may be low because their competitors may use it without the rightful compensation.

Regulation, in the words of Baldwin and Cave, “by making information more extensively accessible, accurate and affordable, may protect consumers against information inadequacies and the consequences thereof and may encourage the operation of healthy and competitive markets” (Baldwin and Cave, op. cit.).

Externalities

Very frequently the lawful activity of an individual or enterprise may incur costs on third parties without a proper compensation. And as they do not absorb the full cost of this negative effect, they will have the incentive to go on doing such an activity if not increasing it.

Pollution is the most common illustration of such a negative spillover effect. As long as the cost of supplying a given product does not internalise the cost of a deteriorated environment (polluted rivers, atmosphere and cities), the most attractive it will be, and conversely, pollution-free production process will be more expensive and less attractive. This is the classical problem of the tragedy of the commons described with details by Hardin (Hardin 1968, Ostrom 1994). By his account, resources open to all, such as the atmosphere and the river basins, tempt their users to overuse them without limit in an environment that is finite. Still on the use of common pool resources, Ostrom and Walker indicate that “without some form of coordination or organization to enable individuals to agree upon, monitor, and sanction the patterns of appropriation by individuals from a CPR [common pool resources], the resource will be overused” (Ostrom and Walker 1997, their emphasis). Regulation therefore, in the form of pro-environment policies enforced by the government bodies, forces the absorption of the costs of anti-pollution devices in the productive chain or levies fines to the polluter, pursuant to the “polluter-pays” principle, forcing them not to overused the common good.

Should the market have a large number of firms competing for the consumers, the compliance to these rules would force them to be efficient or find market niches, for example, by appealing to the environmental conscious consumers. However should externalities be coupled with a monopolist situation, where the consumers have no choice whatsoever, then the firm will pass the costs of fines or anti-polluting equipment to the final prices charged to customers. In such extreme situation, the regulators would have to deal with the monopoly, the externality and with price fixing.

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3 This is a typical principal-agent problem: the principal (the consumer) is less informed than the agent (the supplier) about the conditions of the trade: quality and price.
**Anti-competitive behaviour**

This sort of behaviour happens when firms act in ways not conducive to a healthy competitive environment. Firms that have a lead role in the market cut temporarily their prices below costs to force their competitors out of the market place. Once the competitors go bankrupt or are merged with the dominant firm, prices are raised well above costs in detriment of the consumers, firstly to recover the losses of the lower prices and later to extract rent. In other words the price level is established to exclude from the market an equally or more efficient competitor. This type of behaviour is called predatory pricing, dumping or “excessive competition” in the words of Breyer (Breyer 1990). Baldwin and Cave (op. cit.) state as one of the preconditions for a firm to take part in such activity that it have enough capital to finance the loss making “promotion price”.

What regulation seeks to avoid is the attempt to monopolise or else the conspiracy to monopolise (Viscusi et al., op. cit.). The catch for the regulators in situations like that is to differentiate the dominant position of a firm as a consequence of better and more efficient production process or of predatory pricing.

A classical example of predatory pricing leading to monopolisation was the Standard Oil Company in the USA. The owners of Standard Oil, the Rockefeller family, built their oil empire by purchasing more than 120 rivals, by driving competitors bankrupt, by the control of pipelines (another example of natural monopoly) in order to damage the rival’s capacity to be competitive and by overcharging freight rates (because they also owned railways). Accordingly, by 1890’s, the holding company had a 90% participation of the refine and sale of petroleum and derivates (Viscusi, op. cit.). That was an extreme illustration, which engendered a prompt regulatory response by the USA government.

**Problems with Regulation**

No matter the merits regulation may have in assuring the health and safety of people, or in protecting the consumers from predatory pricing of monopolistic behaviour, regulation is far from being a consensual issue. The criticism is concentrated on four major drawbacks (Francis 1993, Meier 1985, Ayres and Braithwaite 1992, Bardach and Kagan 1982, Vickers and Yarrow 1989, Navarro 1985, Eisner 2000): inefficiency, capture, decline in business competitiveness and disincentive to innovation, and the danger of over regulation and legalism.

**Inefficiency**

Inefficiency translates the belief that regulation will do more harm than good both to the general state of the economy (Eisner 2000). The State is inherently unable to perform regulatory goals in an efficient way. A myriad of directives of different types is enacted, which demand personnel to verify and assess the compliance with the regulatory norms, and also to levy fines and other penalties in the case of default. As for this latter aspect, there is also the cost of potential judicial litigation in the courts, leading to the waste of scarce resources both of the state and of the regulated industry.

Before putting a new product for sale on the market place, the firm has to satisfy several health standards in terms of composition, addition of preservatives, and dates of validity. Not only has the company to do all this by itself in their own laboratories or contracting out, but also the regulator has to double-check it. This double-checking procedure is lengthy and expensive and when multiplied by the amount of different products available in supermarkets nowadays gives an idea of how inefficient and dear the whole process may be.

Critics would argue that self-regulation would be a more appropriate and efficient remedy to this problem. By self-regulation, the companies would establish and check by themselves the standards of their production. A good example of self-regulation happens when the product for sale is granted with a “seal of guarantee” by the association of food industry. Bearing in the label this seal would show the consumer that the product has passed a high standard process of quality control. A different
approach is to grant to another organization, a well-known laboratory for example, the task of assessing the high quality of the product. In both cases the firms would be offering a high quality good without the burden of regulatory norms and the State would be free of a costly process of checking and double-checking.

**Capture**

Some analysts on regulation state that if on one hand the demands for a regulatory framework may emerge as a response to public demand to fix the failures of the market, on the other hand regulation may be used in a collusive way to protect the share of the industries in the sector and their interests instead of promoting a healthy competitive environment or the consumers’ protection. This type of behaviour is known as clientelism, agency capture or producer protection.

The natural close relationship that arises among the regulators and the regulated, even though generally quarrelsome, might be conducive to capture of the former. Since the regulators will have to rely on information supplied to a large extent by the regulated, some form of cooperation must develop. This may give the regulated firms, in the words of Baldwin and Cave, “a degree of leverage over regulatory procedures and objectives, leverage that, over time, produces capture” (*op. cit.*, p. 36).

Regulators are also susceptible to capture because they may have future job interests or prospects after leaving their office, not solely by working for the industry formerly regulated, but also for specialized law and consulting firms dedicated to the defence of the regulated industry. In this case, their behaviour is to favour industry-supported policies or at least not to enforce strict regulatory commandments. This sort of regulator is called “careerist” (Wilson 1989), who is waiting for a “delayed bribery” (Quirk 1981). One possible way to circumvent the danger of capture is to establish quarantine to the officers when terminating their tenure, with the prohibition of their working for the regulated industry for a determined period of time.

**Decline in competitiveness and disincentive to innovation**

In short, the critics of regulation argue that all the rules lead to a decline in industrial competitiveness because it is expensive and burdensome for the industry and ultimately, to the consumers (Meier 1985). This is most common when the regulators proscribe the regulated firm from profiting on the use of more efficient processes of production, or of cheaper or more technologically advanced materials, which would diminish overall costs and increase the return of the firm.

The rationale behind the regulators’ rulings is that if the company is allowed to reap off the benefit of innovation, they might gain an advantage which in the medium run may lead to monopolistic power and all the harmful consequences this may represent. Accounting for that before hand, the regulated industries then have fewer or no incentives to innovate, in detriment again of the consumers. This is a key trade-off in public policy: protection of the consumers against the threat of monopoly, or give the industry free rein to innovate and become more efficient but not be concerned with the distribution of the benefits of that in society.

There are certainly middle way strategies that tend to minimize the costs of this trade-off. Among the feasible solutions one can mention the use of price mechanisms (the most famous and efficient being the so-called RPI-X index) or the allowance of a time span during which the firm can reap off the benefits of the innovation, similarly to a patent licence. In the first case, the index is used prominently for natural monopolies firms and was created during the regulatory discussions preceding the privatization of the telecommunication sector in the United Kingdom, and was later extended to other public utilities (Baldwin and Cave 1999: 226). In this case the price of a product or basket of products is set in advance for a specific period, generally five years and only allowed to be altered by an X value discounted the inflation index as measured by the retail price index. So if the price cap is RPI-5 and the inflation rate was 5 per cent, this would mean 5-5=0, that is, no increase was allowed and the profitability of the firm would be made up by cost saving and efficiency.
Over-regulation and legalism

The final major criticism made against regulation is the potential for over-regulation. The conjecture behind this is that as regulation develops and continues, other values enter into the regulatory framework. As a consequence, there may be a plethora of unnecessary, complex, minutely detailed, and formal rules leading to confusion. This is detrimental to both regulators and regulated for the latter has to comply with a jungle of norms and the former has to monitor the compliance.

This may be caused among other things by the nature of bureaucracy within the government or within the regulatory body to increase their importance and “unsubstitutability”. This is not something new in organizational theory. To the question “what bureaucrats want?” Wintrobe answers that bureaucrats want “bigger discretionary budget, influence on public policy, power, or simply utility” (Wintrobe 1997: 431), and this is what they get once the regulatory commands are abundant and difficulty enough that only the bureaucrats (or expert lawyers) will have the knowledge of regulatory hermeneutics. The concept of bureaucracy “empire building” within an approach of its utility maximization was formalized by William Niskanen (Niskanen 1968).

Another reason for understating over-regulation is the temptation to design over-inclusive rules to be able to respond to the largest possible number of cases. Not only did this increase the amount of regulatory norms but also the number of regulatory bodies, not rarely with superposing competences

4. New Institutionalism

If institutions matter, and one of the assumptions of this work is that they do, then which institutions are employed is a fundamental concern (Shepsle 1986; Rothstein 1998), as well as how they are created. Institutions are to be considered in the present work as, in Riker’s words, “condensed conventions” that reflect attitudes, beliefs, expectations and preferences about “the way things are done” (Riker 1980) or in North’s words, the “rules of the game in a society, or more formally, are the humanly devised constraints that shape human interaction” (North 1999: 3). Still according to North, “in consequence they [the institutions] structure incentives in human exchange, whether political, social, or economic” (idem, ibidem).

One good way to examine the development of institutions is to analyse turning point moments when one tries to change the way institutions work. This standpoint gives the analysts the possibility to look at, when possible, the motives and goals of the reformers. For Riker, a good example of that is the framing of a new constitution for a polity, when, necessarily, participants are consciously trying to rearrange political structures and redirecting incentives for future political actors (Riker 1998: 121). The creation of regulatory agencies in Brazil in 1996 and 1997 undoubtedly represented one of such turning points in the Brazilian political arrangement, as it is going to be shown below in this work.

It is important to state that the analysis here will focus on the advances of the new institutionalism to understand the creation of institutions under scrutiny, viz., regulatory agencies. The “old” institutionalism is best represented by the legalist approach that characterized political science until the 1950’s and that subsists until today. This was the time when political issues were addressed from a hybrid legal and political viewpoint and whose balance depended much on the scholar’s origin as a political scientist or lawyer (Drewry 1998: 191; Thelen and Steinmo 1992: 3). That school was often normative (saying how institutions should be) and the comparative studies focussed more on describing institutional arrangements (constitutions or legal systems) in different countries, or the same country across time (idem, ibidem). This approach did not favour the development of truly comparative studies leading to progress in the explanatory power of theory. At the same time however, it is also important to have in mind that new institutionalism is not a unified approach. There are several sub-approaches to the broad theory, among which one can highlight: normative institutionalism, social institutionalism, rational choice approaches and historical institutionalism.

Normative institutionalism, also known as cognitive conceptions of institutionalism (Peters
1998; Reich 2000), stresses the importance of norms in stating how the organizations should function. In this view, the crucial element of an institution is “the collection of values by which decisions and behaviours of members are shaped, not any formal structures, rules or procedures” (Peters 1998: 208).

Social or sociological institutionalists tend to define institutions more expansively than political scientists including not only rules, procedures and so on, but also symbolic systems. Such definition, according to Hall and Taylor, “breaks down the conceptual divide between ‘institutions’ and ‘culture’”, consequently redefining culture as an institution (Hall and Taylor 1996).

Rational choice approaches to institutions (also known as new economic institutionalism) arose from the perception that there was a growing dominance of pure rational choice models, where rationality is emphasized as a utilitarian calculation of individuals devalued of many “normative and collective aspects of governing” (Peters 1998: 209). The major criticisms to the original view of rationality were made by March and Olsen, who argued that the economicist alignment of such rational models privileged an individualistic dominance of decisions that could be better explained by using institutional factors (March and Olsen 1984). For them political outcomes are a function of three primary factors: distribution of preferences (interests) among political actors who would rank and pursue them rationally, the distribution of resources, and the limitations imposed by the rules of the game (idem, p. 739). Each of these is treated as exogenous to the political system, i.e., preferences are developed within a society and transmitted through socialization, resources are distributed among political actors by some broad social processes, and the rules of the game are either stable or change by a revolutionary intervention exogenous to ordinary political activities (p.739). In other words, institutional thinking emphasizes the part played by institutional frameworks in imposing elements or order on a world in potential disequilibrium so that the outcomes may be more predictable.

At the same time, however, because institutions change over time (and sometimes over space), to picture them solely as an equilibrium solution to the conflicting interests is probably a mistake. They are not only simple reflections of current exogenous forces or a summation of individual behaviours and motives, but also they embody historical experience into rules, routines, etc. that persist beyond the historical moment (March and Olsen 1989: 167). This led to the development of a new version of rational choice version of institutionalism, one that took into account the institutional rules and other constraints in forming the maximizing behaviour and enabling stable and predictable decision-making (Peters 1998: 209). And even this mixed approach of institutionalism and rational choice is not unified. Ostrom (1994) has employed somewhat different rational choice approaches to institutions. Calvert distinguishes three general methods that can be identified in the literature (Calvert 1998). The first of them sees institutions as attribute of individual preferences: the agent’s utility function includes arguments for altruism, cooperation, or observance of social norms, and optimal behaviour under such a utility function is worked out. The other two approaches adhere more closely to the rational-actor idea.

Historical institutionalism scholars stress the role of former or previous institutional arrangements or choices, the argument being that these choices will have a crucial effect on future policies, or even on the configuration of other institutional choices. These institutional arrangements may include, among other things, electoral rules, the relationship amongst the various departments in the government, and the relationship of the government and private actors (Thelen and Steinmo 1992: 2). Hall and Taylor highlight four features of historical institutionalism (Hall and Taylor 1996: 939-942): 1. it has a tendency to conceptualise the relationship between institutions and individual behaviour in broad terms; 2. it emphasizes the asymmetries of power associated with the operation and

\footnote{And for this matter they identify to approaches: calculus and cultural. For the former, the actors behave strategically, institutions provide them with greater degrees of certainty (or uncertainty) with respect to the behaviour of others and such institutions persist because they provide equilibrium in a Nash style. In this matter, this approach is not much different than the rational choice institutionalism. For the latter, the actors still act strategically but also they are influenced by their “individual’s worldview” of routines and other patterns and institutions from this view furnish a framework for action.}
development of institutions. Historical institutionalists are likely to assume a world in which institutions give some groups or interests disproportionate access to the decision-making process, and rather than emphasize the degree to which an outcome makes everyone better off, they tend to stress how some groups lose while others win. This point is also highlighted by Immergut (1992: 28-9); 3. it advocates a view of social causation that is “path dependent” since the political forces will be mediated by the contextual features of a given situation inherited from the past, rejecting the traditional postulate that the same forces will generate the same results everywhere; 4. it is concerned with integrating institutional analysis with the contribution that other kind of factors, such as ideas, can make to political outcomes. It typically seeks to locate institutions in a causal chain that accommodates a role for others factors, notably socio-economic development and the diffusion of ideas in a world that is more complex than that of tastes and institutions often advocated by pure rational choice institutionalists. Still in the same line, Bell highlights as the major strength of historical institutionalism the ability of deriving working models of the preferences through empirical observation and not through abstracted assumptions (Bell 2002: 485).

The Brazilian old and new regulatory institutional backgrounds

The prospect of privatising important firms responsible for the provision of public utilities demanded a new approach of regulation. Before 1997, there were no regulatory agencies as such in the country. The Ministry of Communications (MC) and the Ministry of Mines and Energy (MME) were responsible in Brasília not only for formulating policies for telecommunications and energy (electricity, petroleum and natural gas) but also for monitoring the progress of these policies, executed by the giant state-owned enterprises Telebrás, Eletrobrás and Petrobrás. These companies, although formally subordinated to their respective ministries (and ultimately to the President of the Republic), were hardly accountable to the government. The important for the latter was that the former controlled the prices under their jurisdiction, and this in a way helped keep inflation rates down, something detrimental to the investment capacity of the firms. Their bureaucracy was a strong one, both within and outside the administration, and their portfolios managed funds of the order of tens of billions of US dollars. The fear was that privatising public monopolies without setting a new framework of monitoring or controlling would merely represent the move from a public to a private monopoly, with all the problems this entails, as already seen above in this work.

The great institutional change occurred with the creation of sectoral regulatory agencies, independent in personnel and in budgetary matters, to work as watchdogs of the would-be private firms.6 Even deputies and senators who did not approve the privatisation plans realized that some form of accountability should exist and launched their own bills to create some form of regulatory body. Besides making part of a reform of the State that among other things proposed to change the ethos in the federal administration (Brazil 1995; Bresser Pereira 1998a and 1998b), the creation of such agencies fulfilled another important role. If private parties dealing with the government may be in a weak position since one of these parties (the government) is always making and enforcing laws and other rules that affect both groups, in Brazil the situation was far worse. Having experimented with defaults, confiscations or mere disregard for contracts (because of politicking or macroeconomic reasons), entrepreneurs, investors in particular and customers in general simply did not think that the traditional institutional channels of regulation, i.e., via the ministries, were not in a position to deserve confidence, hence putting in low grounds the rate of commitment lack of credibility. So the regulatory

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5 A definition of independence is not an easy one due to its multiple dimensions and for a discussion on that, see Baudrier 2001.
6 Curiously enough though, electricity companies started to be privatised prior to the changes proposed by the consultants commissioned by the federal government, Coopers & Lybrand, prior to the latter being mostly accepted and transformed in law, and even prior to the creation and functioning of the regulatory agency (for the reports by the consultants see Coopers
agencies served as an attempt to increase this rate of credibility and assure investors that the contracts would not be broken as they had often been in the past. This made it possible to attract more bidders to the firms to be privatized and maximize privatization revenues.

Levy and Spiller state that the credibility and effectiveness of a regulatory framework, and so its ability to encourage private investment and support efficiency in the production and use of services, vary with a country’s political and social institutions, in their words, the “institutional endowment of the country”, such as the courts, customs and informal norms, and the country’s administrative capabilities (Levy and Spiller 1996). The evidence they gather suggests that credible commitment to a regulatory regime can be cultivated even in what appears to be a problematic environment, and that without such commitment long-term investment will not take place. The line of argument of Hill and Abdala is similar and they state that to have a stable and credible institutional regime (on regulation) working before privatization increases the value of a firm in so far as it reduces the risk associated with it, thus increasing the revenues to the government (Hill and Abdala 1996). Stone et al. contend that ideally a market economy will develop institutions (including in their words, “systems of regulation”) that allow the highest value to be attained from its resources and incentive the firms and individuals to “engage in growth-enhancing or redistributive activities (Stone et al. 1998: 92, 97).

In fact Fine, employing evidence gathered from investment contracts and government institutions in telecommunication sectors state that the level of credibility a government has “is a product of the extent to which other believe that it will do what it said it would”, thus, the more credible the government and its institutions are, the less investor uncertainty exists (Fine 2000: 3). In the matrix depicted in table 1, Fine mixes the institutional credibility of the country and the market opportunity. A country or a sector of the industry with low institutional credibility and low market opportunity would get no investment whatsoever due to the inhospitable environment for business. Situations II and III would mix a low institutional credibility and high business opportunities and vice-versa, and in both cases there would be no investments or investments with safeguards of the sort of tax breaks and subsidies in the III case and a regulatory framework to fill in the gaps of commitment. To move towards the IV quadrant requires both safeguard and dispute-resolution mechanisms (Fine 2000: 13-4). The State can have an important role in lowering the costs of contracting between individual actors by providing stable property rights, and as important as that, enforcing the sanctions in case of inobservance of the rules (Eggertsson 1998: 9). This pushes the investment-arrow to quadrant IV.

The exchange between the several actors involved, the government the consumers and the private sector, are called transaction costs, i.e., the costs of measurement and enforcement of such rules. Regulatory agencies in that case would have the end of diminishing such costs to the actors by measuring and enforcing rules and sanctions. An important issue remains however: what would be the optimal design of such institutions. Estache and Martimort state that “in taking transactions costs into account, structures and processes will affect regulatory outcomes and, hence, should be recognised explicitly in the design of incentive-based regulation” (Estache and Martimort 2000: 50). In other words, institutional choice refers to “specifying and allocating decision rights to different actors and determining the rules that govern the way these actors are selected and that influence the way they use

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7 The total amount of revenues raised from privatising federal, state and municipal utility companies in Brazil totalled US$ 65,529 from 1988 to 1998 (World Bank 1999).

8 Even though there is always the problem of future administrators or legislators reneging the institutional arrangements. In order to avoid this, the cost of future change may be increased, e.g., by demanding higher quorums to pass the specific legislation.

9 He makes the point however that occasionally investors will lower their credibility standard requirements because of excellent market opportunities and therefore invest (Fine 2000: 16). This confirms the case of the firms of distribution of electricity in Brazil, see note 6 above.
their discretion” (Horn 1995: 25).

The new Brazilian regulatory framework does not seem to be working in favour of the diminution of costs and of the enhancement of investment as it had been expected. Although it is true that the creation of regulatory agencies stood up for raising good revenues for the government in its privatisation and liberalisation efforts, it has left much to be desired in the aftermath of the process.

Anatel and Anp have defended well the final consumers imposing fines, promoting competition whenever possible and in accordance with the respective legal basis. As examples of their performance, one could highlight the redefinition of the rules concerning the mobile telephony in December 2000, situation that put in conflictive sides the incumbent and the entrant firms. A second illustration was the charge of fines to the firms which failed to operate the new long-distance dialling codes in July 1999. This event brought major disruptions to the telephony system and it was completely re-established 5 days later. Anp has shown some of its power by threatening to withdraw licences from some petrol stations that were supposedly behaving in a cartel-like fashion and hence were artificially increasing the retail sale prices. Perhaps the most important regulatory event to date has been the decision to allow British Gas to gain (paid) access to the pipelines transporting natural gas from Bolívia. Petrobrás is the largest shareholder of the company that owns the pipeline, which to date is still being underused. The regulatory legislation foresees that in cases of idle capacity in pipelines, the competitors should be able to use them paying the due charges. In its condition of quasi-monopoly, Petrobrás saw in that a threat and refused access to British Gas, which in turn successfully appealed against the decision to Anp.

The case of Aneel is much less successful. The shortage of electricity the country witnessed from March 2001 to February 2002 showed explicitly the incapacity of the agency to establish regulatory incentives for the sector to overcome such critical situation. Such weakness was so evident that the government created a super-ministry (CGCE, Câmara de Gestão da Crise da Energia Commission for the Management of the Energy Crisis), with the sole purpose of dealing with the issue. Aneel temporarily lost most of its regulatory prerogatives and the electricity spot market was suspended. The CGCE took emergency measures that proved to be effective in dealing with the shortage. In fact, the CGCE substituted Aneel in this issue. At the time, rumours that the agency was to be merged with Anp were raised (creating a new “energy agency”), and this may be the actual outcome in the near future. One issue still unsettled is when the private distribution companies will receive financial compensation for the losses caused by the shortages, and how much, as dictated by the regulatory legislation. Attempts to consider the debt void, even if fair, could discredit still more the agency and delay further investments in the sector.

The threat to either bypass the regulatory agencies or defy the decisions of the agencies by referring to the judiciary is currently the major backlash affecting the three agencies. The decisions of the agencies are not terminative The Brazilian constitutional arrangement allows access to the judicial system to anyone. In fact this transforms the judicial system in another regulator (or a regulator of a second degree). As the judicial system in the country is complex, expensive and full of loopholes, which could have a more deleterious effect than anything else10. In the pipeline case, Petrobrás threatened to appeal against the decision to the judicial courts, in which case a regulatory confusion would have ensued, but gave up. More recently, one of the incumbents providing long-distance services has prevented local and regional companies to enter that niche hence enjoying the benefits of duopoly11.

10 In theory a civil action in Brazil can pass through four different levels: in an initial stage, there is the first-degree judge and the tribunal above him/her. Then, if a question of legality (concerning federal legislation) remains unsettled, the action can pass to the STJ (Superior Tribunal of Justice), and finally should there be constitutional matter involved, the action can pass to the STF (Federal Supreme Tribunal). The last two courts are located in the Federal District.

11 The incumbent uses a two-way argument in its plea: that local companies have not clarified the interconnection charges clearly (then cross-subsidising services, which is illegal) and that Anatel used a wrong administrative way to grant the right to make long-distance calls to the entrants.
5. Conclusion

The incapacity of the federal regulatory agencies studies in this work has made the industry more uncertain of what are the cards on the table. As the most serious illustration of such situation, the federal administration had no other alternative but to organize an ad hoc regulatory authority in May 2001 to try to solve the shortage of electricity and all the problems thereof. Even though such provisional measure has succeeded in mending the situation, it has undermined still more the credibility of the agency. Besides, one cannot forget however the condition of the industry in the telecommunication and the petroleum and natural sectors. This may be a result of a bad designed regulatory framework or a system of regulation deeply inconsistent with its political traditions or other institutions of the country. This has resulted in insecurity in the market and dissatisfaction both for the investors and the consumers, which might lead the endeavours to privatise, liberalise and regulate to end up instead in recrimination and a resurgence of demands for renationalisation.12

Other issues that have not been contemplated in this paper remain an important concern in the future of the research. Two potentially conflictive questions may be worth referring to. One is the rivalry among the regulatory agencies themselves (Aneel and Anp did not show a cooperative response to the energy crisis before the special commission was formed; Anatel and Aneel have not agreed on how to regulate the use of electricity masts to be utilised by the telecom firms; and the still non-cooperative behaviour of all of them vis-à-vis the anti-trust courts CADE). The second problem is the recourse to the judicial power as a means to undermine the decisions and prerogatives duly established by the law to the regulatory agencies.

References


12 Neither the electricity shortage nor the regulatory mess in the sector have prompted calls for renationalisation of the distribution and the (state) generation companies. However, both the sale and the reorganisation of the federal electricity generation companies formally due to happen in the beginning of 2001 did come to a sine die halt.


Biographic summary

Marcelo Gameiro de Moura is doing his doctoral studies at the Department of Government of the University of Essex, United Kingdom. He is Bachelor in Law by the Federal University of Pernambuco (Brazil, 1995), Master in Political Science by the University of Brasília (Brazil, 1999) and has an MA in Latin American Government and Politics by the University of Essex (2000). He worked as a researcher, consultant and teacher at the National School of Public Administration (ENAP), Brasília (Brazil) in 1998 and 1999. Still in 1998 he worked as a political analyst for MCI, Brasília. In 2000-2001 and 2001-2002 he was Graduate Teaching Assistant in the Department of Government of the University of Essex for the course Introduction to Latin American Politics, and in 2002 he lectured on the same course. His major interests are the politics of regulation, comparative politics, and political economy in Latin America in general and in Brazil in particular.

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### Tables and graphs

**Table 1**

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