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THE POSSIBILITY AND IMPOSSIBILITY OF RATIONAL REGULATION IN GOVERNMENT

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Abstract

The traditional theory of regulation assumes that government implements regulation in response to market failures. The orthodox view only justifes economic regulation, but does not account for the costs and dangers of regulations. Government regulations have the potential to bring benefits for the people, but they also have potential to be abused and to bring benefits for the special interest groups at the expense of general public. One can understand and justify the reasons why economic regulations are necessary, however one must also accept that it is impossible to enact rational regulation. For example, rational ignorance of the general public results in irrationalities when economic regulations are chosen to implement at the political decision making process. There is such a thing as impossibility of rational and efficient regulation.

This paper aims to explore the possibility and impossibility of rational regulation are discussed from the perspectives of public choice economics, economics of property rights, new institutional economics and constitutional economics.

Keywords: regulation, cost of regulation, public choice economics, property rights.

JEL Classification: H4, K2, L5

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capable of general application"
(Hayek, 1987:129.)

"...there are two reasons why all controls of prices and quantities are incompatible with a free system: one is that all such controls must be arbitrary, and the other is that it is impossible to exercise them in such a manner as to allow the market to function adequately."
(Hayek, 1960:228.)

"The state –the machinery and power of the state- is a potential resource or threat to every industry in the society. With its power to prohibit or compel, to take or give money, the state can and does selectively help or hurt a vast number of industries."
(Stigler, 1971:3)

I. INTRODUCTION

This paper is an introductory survey on the costs of regulation and aims to explore a theory of rational regulation. The paper is organized as follows. In Section II, both benefits and costs of economic regulations are explored. In Section III, we will try to answer to the question of "is government regulation necessary in a market economy?" Then, the possibility and impossibility of rational and efficient regulation will be discussed. The last section includes concluding remarks and gives general recommendations to improve the quality of government regulation policies.

II. THE COSTS OF REGULATION

What are the disadvantages of regulation? What costs to regulation impose on individuals and society? It has been advocated that regulation brings various types of costs on individuals and national economy, as a whole. Each type of government regulation and control results in some specific effects. In the following, I will sum up the most important costs of regulation.

The costs of regulation can be summarized as follows:

- Costs of formulating, implementing and maintaining regulation by the government,

- Cost of compliance with the rules for industry and individuals; transaction cost (Williamson, 1979.)
- Deadweight cost (Deadweight consumer loss.)
- Rent seeking cost (Tullock, 1967; Tullock, 1993. Krueger, 1974; Tollison, 1982.))
- Resource misallocation and x-inefficiencies,
- Moral hazard.

It is obvious that regulatory government first results in administrative costs. Governments spend a great deal of money for creating, implementing and maintaining the regulations. Regulatory bodies are constructed for this purpose and they spend huge amount of money.

Secondly, individuals and companies have to obey the regulation rules and they spend money for the compliance. Compliance cost is one of the costs of regulations that individuals and companies have to bear. Compliance costs include transaction costs and information costs. There may be an opportunity cost, because individuals and companies spend a great deal of time and effort to learn and obey the rules and commands of regulatory government, instead of engaging productive economic activities.

Compliance cost is not only that individuals and companies have to bear. In addition, there are transaction and information costs. There may be an oppurtunity cost, because individuals and companies spend a great deal of time and effort to obey the rules and commands of regulatory government.

One of the most important cost of economic regulations is "welfare loss" and "rent seeking" due to restrictions at the market caused by government. Economists also calls welfare loss as "deadweight cost." Now, let's explain these two costs.

As known, certain industries considered natural monopolies such as railways, postal and telecommunication services, electricity, gas and power supply are usually provided by public utilities in many countries. A natural monopoly industry is usually turned over a statutory monopoly or government might give an exclusive right to a firm allowing it to provide goods and services.

Monopoly, whether private or public, causes a welfare loss in society, because monopolist tends to reduce output and thus increase price and profits. This attitude of monopolist results in "contrived scarcity" in the marketplace.

The second cost of the monopoly is the total value of the resources used to capture monopoly profits. This is called *"rent-seeking"*, which became a hot topic in the economics studies in recent years.

Suppose that some individuals or companies lobby with government to obtain a monopoly privilage, hence have a monopoly profit. Expenditure of resources to capture a monopoly right from government is a social cost, because the oppurtunity cost of rent seeking expenditures is equal to the money, that could otherwise be spent for productive activities. To pay lawyers to take a dollar out of the pockets of consumers and put it into the pocket of the monopolist reduces GNP by the amount of what the lawyers would have produced if engaged in productive pursuits. Not only lawyer's, but also lobbyists, accountants, executives and secretaries may be involved in the effort to secure a monopoly transfer. If the competition to capture these transfers is sufficiently strong, resources will be wasted in the process up to the amount of the transfer. (Ekelund-Tollison, 1986; 223)

Although rent seeking is usually associated with the process of seeking monopoly privilages from government, it indeed includes all kind of activities of spending resources in competing for artificially contrived transfers from government. In this sense, *"monopoly seeking"* is just one kind of efforts to obtain a transfer.

Rent seeking, in broad sense, is used to describe attempts both to obtain and to maintain wealth transfers (Pasour, 1987; 123) In other words, rent seeking is the expenditure of scarce resources to capture an artificially created transfer. (Tollison, 1982; 578) Rent seeking takes many forms, such as monopoly seeking, tariff seeking, license seeking, grants/subsidy seeking etc.

The most important conclusion to be drawn from *"rent seeking"* or *"welfare seeking"* theory is that expenditure of resources to obtain artificially contrived transfers is a social cost. As a matter of fact, The efforts to obtain transfers from government are legal up to a certain point. However, when there is a strong competition, rent seeking takes some other "illegal" forms such as bribery, tariff evasion or smuggling etc. As noted by Ann Krueger, *"in many market- oriented economies, government restrictions upon economic activity are persasive facts of life. These restrictions give rise to rents in variety of forms, and people often compete for the rents. Sometimes, such competition is legal. In other instances, rent seeking takes other forms, such as bribery, corruption, smuggling, and black markets."* (Krueger, 1974; 291)

Rent seeking expenditures do contribute nothing to the GNP, by contrast, it reduces GNP by the amount of what the rent seeking society would have produced if they engaged in productive activities. In brief, rent seeking on the first level, although it is legal, is wasteful. At the second level, the process is illegal, because rent seeking takes such forms as bribery, corruption, smuggling etc. to capture wealth transfers from government.(Aktan, 1993/a)

Finally, we should remark that regulation can be seen an instrument of wealth transfer- the extent of which is determined in a political market -where interest groups demand regulation and politician- regulators supply it. (Migue, 1977.:214.) There may be some other costs that regulation imposes on individuals and economy. Regulation of publicly owned enterprises bring x-inefficiencies. In a private enterprise, both internal control (by the shareholders) and external control (by the capital market) provide incentives to avoid inefficiency. Share holders monitor managers to ensure that they maximize income, if managers fail to do so, shareholders will sell their shares, while other managerial groups will bid for the control of the company in the belief that they will be able to obtain a better return from the company's resources. In a public enterprise, capital market monitoring does not work, while internal monitoring will be performed by politicians who are not necessarily interested in how efficiently managers allocate resources (Pera, 1989, 170) On the other hand, x-inefficiencies arise due to monopoly status of some publicly owned enterprises (POEs). There is obviously no competitive pressure to minimize the costs of production for public utilities, which have monopoly status.

Lack of incentives for workers and managers are the other sources of x-inefficiencies in publicly owned enterprises. As a matter of fact,. there is no direct linkage between the profitibility of the firm and the incomes of the workers and managers in POEs. So, work effort will be less in POE than a private enterprise. Another thing is that the public enterprise will not be driven out of business, if fails to achieve productive efficiency. In sum, higher production costs caused by x- inefficiencies are another social cost of monopoly and of regulation.

On the other hand, one of the cost of regulation is moral hazard. It refers to increased risk of loss, or increased cost, incurred by one party to a contract when the other party adopts a less careful attitude. An typical example for moral hazard is that a person insured against car theft may be more careless about taking precautions to avoid car theft. This encourages more car theft, thus raising the cost of car insurance. Moral hazard thus result from careless but legal behavior. (Spencer, 1990:658.)

Regulation may also affect firm conduct negatively. Averch & Johnson anlyzed the regulated firm behaviour and concluded that cost-of-service regulation gives a firm incentive to distort its input choices, usually overcapitalizing to expand its rate base. (Averch and Johnson, 1962.) According to the Averch & Johnson, rate-of-return regulation may encourage the public utility to overinvest in capital and expand into other markets in order to increase its rate base and hence increasing the aggregate amount of profits it could earn subject to the regulatory constraint. (Netz, 1999.)

III. IS GOVERNMENT REGULATION NECESSARY IN A MARKET ECONOMY?

No doubt that some kind of government regulations are necessary in order to have a better working market economy. As we have explained in the previous sections, some kind of market failure is a legitimate and convincing reason of government regulation. But we should be careful to distinguish two kind of regulations*:* *"regulation as intervention in market processes"* and *"regulation as framing of market processes."* (Vanberg, 1998:3.)

As defined earlier, regulation, *"refers to the implementation of rules by government agencies that is backed up by law."* (Brown & Jackson, 1994: 48.) Within this definition, *"regulation as intervention in market processes"* means that government enacts "coercive rules" for the operation of market processes. In other words, if economic activities are regulated, guided and controlled by authoritarian decrees and prohibitions, these kind of rules can be considered as "regulation as intervention in market processes." Imposed price ceilings and floors (price controls), mandated quality specifications, efforts of regulators to legislate prices at other than equilibrium levels are some examples for *"regulation as intervention in market processes"*

Second type of government regulation, which is *"regulation as framing of market processes"* refers to basic working rules and institutions in a market economy. These kind of regulations does not interfere with the decisions and choices of the individuals at the market. Individuals are free to choose and they make their own decisions without a force or command. If government determines an "economic constitution" -that is the general legal-institutional rules and framework requirements of an economic system-, this can be seen the essential institutional foundation of a market economy.

"Regulation as framing of market processes" can be considered as *"regulation by rules"* and on the other side *"regulation as intervention in market processes"* can be seen as *"regulation by commands."* If this distinction is true, we may argue that *"regulations by commands"* are not suitable for the market economy, but *"regulations by rules"* are rational and therefore necessary for a proper working market economy.

IV. IS RATIONAL AND EFFICENT REGULATION POSSIBLE?

We have reached a conclusion that some "regulatory framework" is necessary in the market economy, but we have not answered to the question of whether or not it is possible to set up and implement a rational[1] and efficient regulation framework and policy. The answer to that question is not a simple yes or no. Economists, who have studied the effects of regulations generally concur two points: (Spencer, 1990:612.)

-The economic regulations that prohibit restrictive agreements and various anticompetitive practices help the market work more efficiently.

-Most of the remaining economic regulations and some social regulations might impose high social costs on firms without providing corresponding improvements

[1]The term "rational" in this article is synonymous with efficient. The concept here we use should not be confused with the logical definition- which referes to pertaining to logical propositions.

in benefits. These might impede the market's ability to function effectively. Consequently, they impair efficiency.

In general, there are two reasons for inefficient regulation. One is economic and the other is political. The economic reason is that it is difficult for a government authority to regulate firms because it lacks the adequate information. The firm usually is better informed than the regulator; moreover, it rarely has an incentive to tell the regulator all it knows. This "information asymmetries" problem results in inefficiencies for regulation.

Israel Kirzner, an Austrian economist who defends an "unregulated market economy" strongly, say that "*but what is the likelihood that government officials... will know what imposed prices, say, might evoke the 'correct', desired actions by market participants? ... How do government officials know what prices to set (or qualities to require, and so forth)?"*[2] (Kirzner, 1985:139.)

Besides this economic reason, there is also political factors that impedes to achieve efficient regulation. Since regulations redistributes resources and rents, politicians often use it to secure political gains rather than to correct market failures. A large array of regulatory instruments, such as quotas, licences and subsidies, are used to transfer significant amounts of wealth from consumers to small groups of producers. This is obviously an inefficient result. (Guasch and Hahn, 1997:3)

Some of the most interesting issues regarding regulation arise because regulations are the product of a democratic decision-making process rather than an omniscient government. When democratic governments are involved, all interests are represented, and often the interests of those who are to be regulated are represented more strongly than are the interests of those the regulations are intended to benefit. Natural monopolies such as electric utilities and telephone companies are often regulated by public service commissions to try to overcome some of the inefficiencies of monopoly. Not surprisingly, the regulated firms participate actively in the process to try to push regulations to favor the firms, while the consumers who are supposed to be the beneficiaries of regulation are rarely even aware of the type of regulation that takes place. The real issue, then, is

[2] Quoted in: Vanberg, 1998:5.

not in the abstract how beneficial an ideal regulation could be, but rather, given the realities of the political process, what type of regulation is likely to emerge. (Holcombe, 1988.)

One of the strong advocates of the free market economy, Friedrich August von Hayek also criticizes government regulations and say that regulations might bring arbitrary decisions in the government and also infringe the generality principle of the rules. He was critical of government regulations in his well-known book the Road to Serfdom:

"Any attempt to control prices or quantities of particular commodities deprives competition of its power of bringing about an effectice co-ordination of individual efforts ... This is necessarily true, however, of measures merely restricting the allowed methods of production, so long as these restrictions affect all potential producers equally ... To prohibit the use of certain poisonous substances or to require special precautions in their use, to limit working hours or to require certain sanitary arrangements, is fully compatible with the preservation of competition. The only question here is whether in the particular instance the advantages gained are greater than the social costs which they impose."[3] (Hayek, 1944:228.)

In his Mirage of Social Justice, he also writes that economic regulations are not good for two reasons:

"...there are two reasons why all controls of prices and quantities are incompatible with a free system: one is that all such controls must be arbitrary, and the other is that it is impossible to exercise them in such a manner as to allow the market to function adequately."[4] (Hayek, 1960:228.)

Hayek also insisted that "generality rule" is very important for justice and other aims. He thinks that government regulations will spoil the generality principle and bring special privilages at the expense of others. He writes:

[3]Quoted in: Vanberg, 1998:6.
[4]Quoted in: Vanberg, 1998:6.

"Every act of interference thus creates a privilage in the sense that it will secure benefits to some at the expense of others, in a manner which cannot be justified by principles capable of general application" (Hayek, 1987:129.)

So far, we have tried to explain the reasons why rational and efficient regulation is difficult and maybe impossible to implement.

Before closing this section, I would like to give a different approach to the issue of rationality of regulation. A German economist, Viktor Vanberg approaches the "rationality of regulation" from another perspective and reaches a conclusion:
"If one approaches the 'rationality of regulation' issue in light of the notion of the market as an arena of voluntary contract it would seem natural to suppose that the principle of freedom of contract may provide the criterion for judging which general regulations are and which are not compatible with a liberal order. Accordingly, those regulations ought to be rejected that interfere with the process of voluntary contracts among market participants, i.e. regulations that prohibit transactions that market participants would voluntarily enter into. The obvious rationale behind such judgement would be that prohibiting voluntary transactions means to prevent the realization of mutual gains that the contracting parties expect to get, as they indicate by their voluntary agreement. Accordingly, regulations that prohibit voluntary transaction between market participants could be said to be welfare-decreasing and in the sense 'irrational.'" (Vanberg, 1998:14.)

According to Vanberg, rationality of regulation ought to be evaluated by looking at voluntary contract and market transactions. If regulations did not hinder voluntary contract, then regulations would be accepted rational and outcome would be efficient.

V. REGULATION BY COMMAND VERSUS REGULATION BY RULES

We should note here that economists moved their attention to rules and institutions in recent years. Several schools of economics (virginia school of political economy, Chicago school of economics, new institutional school etc.) concentrates on rules and institutions and reaches a conclusion that *"good game depend on good rules."*

Government regulation as a *"framework rule and institution"* is necessary and actually productive for the market economy. However, government regulation as a *"command rule"* is harmful for the market economy and tends to be counterproductive.

New institutional economics, which is one of the schools of economics that analyzes the rules and institution, strongly defends that rules and institutions shape economic performance. (North, 1996.) According to this school, institutions are social constraints that emerge when rules, ranging from constitutions to social norms, are enforced. (North, 1990.) In other words, institutions are the rules of the game in a society. They are composed of formal rules and informal constraints. Formal rules include political rules, economic rules, and contracts. Political rules broadly define the hierarchy of the polity, its basic decision structure, and the explicit characteristics of agenda control. Economic rules define property rights. Contract contain the provisions specific to a particular agreement in exchange.[5]

Institutionalists believe in that institutions facilitates division of labor and human creativity. For example, traffic rules –a set of institutions- impose constraints on individiual drivers but allow the generality of people to travel more speedily and safely; and institutions that establish protected property rights enable people to buy, sell and grant credit to others. The key function of institutions is to facilitate order: a systematic, non-random and therefore comprehensible pattern of actions and events. Where there is a social chaos, social interaction is excessively costly, confidence and cooperation disintegrate. (Kasper and Streit, 1998. p.28.) A well defined private property right system is an institution and essential for higher economic performance. (Demsetz, 1998.)

In addition to institutional economics, a newly emerged research field, Constitutional Economics also analyzes regulation from the perspectives both *"regulation by command"* and *"regulation by rules."* Constitutional economics, as an extended research program that emerged from public choice,[6] studies basic

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[5]See: Douglas North, The Contribution of the New Institutional Economics to an Understanding of the Transiton Problem". (UNU/WIDER 1997 Annual Lecture), http://www.wider.unu.edu/northpl.htm p.2.)

[6]Public choice theory, which is the application of the methods and analytic techniques of modern economics argue that economic regulations are the result of government growth. Increasing government regulations result in inefficiencies. Moreover, government regulations creates

rules under which social orders may operate. (Brennan and Hamlin, 1994:401-409. see also: Buchanan, 1989.)

Founding father of the constitutional economics, Nobel laureate James M. Buchanan sees a constitutional-institutional framework essential for the market economy. He thinks that *"there is proper role and function role of collective action in the design, construction, implementation, and maintenance of the structural framework within which any market economy is allowed to function. Social and economic objectives might be advanced without overt politicization of markets."* (Buchanan, 1991: 216.)

Buchanan, does not like a "regulatory government" in the sense that government directly guides, regulates and controls the economic activities by authoritarian decrees and prohibitions, but he strongly advocates a "regulatory government" in the sense that "structural framework" is designed and implemented in an economic constitution.

According to Buchanan, government ought to have these regulatory functions only: (Buchanan, 1991: 216.)

1. Property rights must be widely dispersed in ownership, and the pattern of ownership itself must be afforded explicit legal protection.
2. Private owners must be allowed to exchange owned rights to property among themselves, and there must be political-legal enforcement of voluntary contracts made for the exchange of these rights.
3. The political agency, the state, may take on the responsibility of defining the monetary unit for the economic order and may, ideally seek to maintain stability in the value of such unit.
4. There should be specialized institutional arrangements aimed at promoting competitive forces, especially those that promote freedom of entry into production and that prohibit cartel agreements.

"contrived rents" and finally a rent seeking society emerges. Public choice scholars strongly criticizes government regulations.

5. Pure public goods (for example, national defence) should be brought within the state's authority.
6. Negative externalities might require government regulation. Corrective taxes may be necessary to compensate the cost to the society due to environmental damages.

According to Buchanan and other constitutional economists, basic structural rules of a market economy should be established. Buchanan do believe that minimal politics is essential for an efficient market order. Minimal politics ought to be responsible for only determining the structural framework for the market economy. But he warns that *"politicatization of markets"* through government regulations impairs market economy to function efficiently.

In sum, constitutional economics, as opposed to orthodox economics is only interested in determining the general rules and constraints on the use of economic power by the government.

Constitutional economists do not like interventionist economic policies such as fiscal and monetary policies. For example, government should not use monetary policies as a tool to realize certain macroeconomic goals. A monetary policy designed to realize full employment and other macroeconomic goals by using such instruments as open market operations, discount ratio etc. are not favored by constitutional economists. Monetary policy is kind of economic regulation. But constitutional economist is not directly concerned with determining whether monetary ease or monetary restrictiveness is required for furthering stabilization objectives in a particular setting. On the other hand, constitutional economist is directly concerned with evaluating the properties of alternative monetary regimes (e.g., rule-directed versus discretionary, fiat versus commodity standards). (Buchanan, 1991.)

According to constitutional economists, compensatory fiscal policy as suggested by Keynesian economists and functional finance scholars is not good for the economy in the long run. Government should only determine the basic rules and general framework of the fiscal order. For example, government should not make frequent changes on tax laws, instead of it, government should only determine the "tax constitution." They say that a tax constitution is a crucial ingredient in generating predictability in economy and finally result in long term economic growth. Frequent changes in the tax law destroy the tax system and make it worse. Predictability can be secured by rules only. Rules provide stability and regularity in actor's behaviour. Besides, the rent seeking effort would be reduced if tax system is designed at the constitutional level. Year-to-year legislation increase the rent seeking efforts, which are socially wasteful.[7]

VI. CONCLUSION AND RECOMMENDATIONS TO IMPROVE THE QUALITY OF GOVERNMENT REGULATIONS

One can understand and justify the reasons why economic regulations are necessary, however one must also accept that it is impossible to enact rational regulation. For example, rational ignorance of the general public results in irrationalities when economic regulations are chosen to implement at the political decision making process. There is such a thing as impossibility of rational and efficient regulation.

The danger of regulation, even when the goals of regulation are well thought out, is that the general public is rationally ignorant of most of the government's activities, whereas special interests groups constantly lobby to alter the government's activities to provide themselves with special interest benefits. As a result, even programs that start with good intentions can end up favoring special interests over the general public. (Holcombe, 1988:368.)

By taking into consideration of the fact that there are dangers of government regulation, we must take a realistic view and think what regulation might accomplish. We should accept that there is such a thing as market failure, but also there is governmental failure. There are much to learn from both theories, the theory of market failure and the theory of government failure.

As we noted above, we should always keep on our mind that government regulations create not only benefits but also social costs as well. Therefore, It is necessary to find some guidelines or criteria to improve the quality of government regulations. Any regulation, deregulation or reregulation efforts ought to take into consideration the following recommendations: (See: Spencer, 1990:612-615.; OECD:1995.)

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[7] For tax constitution proposal see. Buchanan, 1977; Buchanan, 1984; Buchanan, 1993.

1. *Benefit-Cost Analysis:* An evaluation of the existing regulations should be made carefully and the current and also expeced benefits and costs ought to be determined. According to this benefit-cost analysis, some existing regulation programs should be eliminated.
2. *Sunset Laws:* Parliament may adopt "sunset" legislation, which consists of laws that are scheduled to expire on specified dates. If government regulations were subject to such legislation, then parliament would have to review them periodically to decide whether they should be renewed.
3. *Transparency in Regulatory Budgets:* It is very important to see both the direct and indirect costs of government regulations clearly. Direct costs of government regulations consists of administrative costs (such as wage and salaries) and also costs to business of complying with them. The budgets of regulatory bodies should be transparent and published in detail in a report every year. Transparency is always the enemy of those who seek to take the wealth of others. (Crew & Rowley, 1988:64)
4. Free *Market Alternatives:* Some of government regulations can be delegated to private organizations. Free market alternative is sometimes a better solution to eliminate the negative effects of government regulations. It is usually more efficient to inform consumers fully about products or hazards than to require goods to meet certain standards. Negotiation and self-regulation are two applicable alternatives to government regulation.

Ronald Coase[8] argued that an efficient solution to the problem of social costs would involve negotiation between the polluter and those affected by the pollution. In the real world, such negotiations between parties help solve a variety of potential social cost problems. For example, restaurant costumers have influenced restaurants to segregate smokers from nonsmokers, eliminating the social cost of tobacco smoke. Coase also suggested that parties, if necessary may solve the problem by applying to the courts. Courts could determine the relative

[8]Ronald Coase, a well-known American economist is generally critical of the effects of regulatory law, believing that solutions to market failure can and do exist outside of government intervention. His theorem, usually known as Coase therem states that an efficient allocation of resources can result from a process of negotiation in the case of clearly described property rigths and in the absence of transaction costs. (Coase, 1960)

costs involved and could assign liability to the party whose cost of adjusting to the social cost are lower. (Tollison & Ekelund, 1985:460.)

Self-regulation is also an alternative to government regulation. Self-regulation encompasses a wide range of arrangements, from private ordering without resort to legal rules to state-enforced systems of delegated rules. Spontaneous private legal ordering is one kind of self-regulation that emerges independently of state intervention. There were numereous examples for this kind of private ordering in the history. One example is that commercial banks voluntarily become members of private protective and certifiying agencies. (Ogus, 1999.)

The other kind of self-regulation is delegation of the state's law-making powers to an agency, the membership of which wholly or mainly comprises representatives of the firms or individuals whose activities are being regulated. Government may empower self-regulatory agency for the tasks of rule-formulation, monitoring, adjudication, and enforcement. This may be called as "privatization of regulation." This is good because monitoring and enforcement costs by government are reduced at first. Secondly, information costs would be low for consumers since the self-regulatory agency might have better expertise and technical knowledge than the governmental regulatory agency. (Ogus, 1999.)

Despite the beneficial outcomes that can be obtained from state delegation of regulatory task to self-regulatory agencies, there is also danger of rent-seeking activities. Interest groups representing the regulatees may engage activities to influence the legislature and bureaucracy to capture special privilages. Obviously, this is a negative side of self-regulatory system.

One of our conclusion is that since a limited government is essential, there will be a need for government regulation. As we all know, government performance is under pressure and many democratic governments have been implementing government reforms, that encompasses such reforms as downsizing, privatization, deregulation etc. Now that it is quite difficult to formulate, maintain and implement rational regulation policies and also maintain the effectiveness and efficiency for the government regulation programs, we should keep this question on our mind and find solutions to it: *"Where are the limits of regulation?"*

Another conclusion of this paper is that it is always a danger substituting rules with authorities. In other words, substituting authorities for rules is a threat for a free society. Authority might be necessary to design, construct and implement of the rules for framing market processes. Authority might also be essential to observe and control of the rules and institutions in the market economy for purpose of whether the rules are implemented effectively and not being violeted by market participants. Beyond this, authoritarian regulations (regulatory commands) often tends to be counterproductive and harmful. The failure of regulation accrues because of substituting authorities for rules.

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