Does Independence Matter? An Analysis of Regulatory Behavior

Eli M. Noam

This article tests the proposition that the independent status of a regulatory agency affects its regulatory policy. Using a large set of data for local building codes, the study finds no confirmation for this view. However, it observes that independent agencies enjoy greater material benefits—in terms of budgets, salaries, and the like—than do nonindependent agencies.

One of the tenets of the American regulatory system is abiding faith in the principle of regulatory independence. On both the state and the federal levels of government the main institution of regulation has been the independent commission, a hybrid creature with extensive powers located in the no-man’s-land between legislative, executive, and judiciary, encroaching on all three but reporting to none. Yet there is nothing to suggest that an independent commission is essential to regulation. Indeed, many regulatory agencies do not follow the model of independence and are, instead, comfortably a part of the federal or state executive branches. Clearly, there are advantages to having a consistent regulatory policy which is determined and coordinated by the executive, as it is in most other countries. Why then have that peculiar institution, the “headless fourth branch of government” which muddies the elegance of Montesquieuian separation of powers? The historical explanation lies in the beliefs of the Progressive Era, whose godchild the independent commission is. The Progressive movement, a reaction to the corrupt machine politics of its time, sought to take as much public decision making as possible out of the hands of politicians. In the electoral area, it created the primary system; in the municipalities, it advanced the city-manager form of government; and in the regulatory field, it advocated the independent commission, hailed as a group of selfless experts insulated from the corruption of politics. But has this system worked as intended? Today, when many other underlying assumptions of regulation are challenged, the concept of independence must also undergo review. Does independence make such a difference as to justify its administrative complexity? Many observers of the regulatory system have pointed to the flaws in
independence: for example, that commissioners are beholden to the official who appointed them. Yet such observations, even if true, are only meaningful when there is a difference in policy flowing from “true” independence. Ultimately, this is not a question of political theory but of empirical fact: does independence matter?

To this question, the paper gives the following answer: Yes, at least for the type of regulatory agencies that were investigated, but not in the way that was expected, that is, not by providing a different, “independent,” regulatory policy. Instead, independence increases the rewards and benefits to the observed agencies for providing essentially the same regulatory policy. Independence does not affect regulation as such, but seems to be beneficial to the regulating agency itself.

Conceptually, this can be explained once one considers the view that regulation is not determined by consideration of public benefit alone. The assumption that a regulatory agency acts in its self-interest as an institution has been made by many writers, following William Niskanen’s [11] lead. George J. Stigler [16] and Sam Peltzman [14], in particular, have developed a theory of regulation which views it as a redistributive act of government for which there is constituency demand in return for political support. A regulatory agency may, in the abstract, select some regulation on the basis of “objective” economic conditions; but it may deviate from this preferred initial regulation if it is to its advantage as an institution. Various interest groups attempt to induce such deviations in exchange for support, and some bargaining of policy in exchange for support takes place. As in any bargaining transaction, the relative strength of the parties affects the exchange. Where an agency is part of the executive, its bargaining position may not be strong, since an interest group can obtain the desired policy by going through other parts of the political system, for example, by supporting a governor, important legislators, or party chiefs. In effect, an interest group has some latitude in choosing its mix of support in the body politic to achieve a desired outcome. On the other hand, if an agency is independent, it is in a more exclusive position to supply a desired policy. Interest groups have fewer alternative sources for the policies which they favor, and they may have to pay a higher “price” in terms of support in order to obtain a favorable policy or prevent an unfavorable one.

Support is important to an agency, because it translates into rewards, which may include influence [1], and, on a more material level, into budget allocations and job security. Hence one can expect that, ceteris paribus, an independent agency has a higher budget allocation than a less-supported one.

To test this hypothesis, we specify the rewards $W$ to an agency as a function of regulatory policy $R$, independence $I$ and other factors $X_i$, such as the local tax base, the professional quality of the agency’s employees, and so on:

$$W = f(R, I, X_i).$$

Regulatory policy, independence, and rewards are intertwined. While re-
wards are a function of independence and regulation, a functional relation also operates in the opposite direction, affecting regulation through rewards and independence. The rationale for independence in agencies is, after all, that it affects regulatory policy. Similarly, the reason for interest-group support to an agency is that it alters regulatory policy from what it would be without that support. This can be expressed by a function of the form

\[ R = g(I, W, L), \]

where \( L \) is a vector of objective factors that affect regulation, such as the local conditions of the industry that is regulated.

We, therefore, have a system of simultaneous equations in \( R \) and \( W \), and any test for the effects of independence must take that simultaneity into account in its estimating procedure.

The empirical analysis of this paper investigates the regulation of building standards in a large number of American cities. The hypothesis is that the relative independence of the agencies which are responsible for building codes does not materially affect these regulations, but that it increases the material support which the agencies receive.

Building codes are the local standards for the quality, construction techniques, and materials in the building of residential and commercial structures. They are of great importance to the interest groups involved in construction. Code provisions approve labor-saving techniques and permit new types of materials. Because of the potential reduction in demand for the services of skilled craftsmen, construction unions have usually favored restrictive codes. Builders, on the other hand, benefit from liberal codes since they reduce the cost of construction and the need for unionized labor. In contrast to these intense concerns, the interest of the general public in building codes is limited, partly due to their low visibility and high technicality.

Building codes are almost always subject to local regulation and are typically administered by building departments. Building officials set code standards, pass judgment on technical building plans, and inspect construction in progress. Political pressures are pervasive in the process. “Code design and code enforcement do not take place within a political vacuum. Building codes have important economic meaning to those favored or not favored by the specific standard” [8, pp. 139ff].

As Charles G. Field and Francis T. Ventre [8] observe in their wide-ranging study of building departments,

Most local building officials... are very sensitive to political pressure... Thus it is that building departments, by and large, have acquired reputations... for being responsive to the needs of their clients, the members of the local building community. Despite the tenuous hold that building officials have on their positions, their official actions have powerful economic consequences for a sizable portion of the local economy... builders are widely known for their aggressiveness and political sophistication... One can readily visualize [the] pressures that converge on the local building officials in these circumstances. [8, p. 140]
Unions are similarly forceful: "When Kansas City changed ... the building code to allow for the use of plastic and copper materials, the A.F.L.-C.I.O. cancelled a scheduled convention in the city, and the local plumbers' union collected signatures to force a referendum on the issues" [9].

The budget of a building department is determined similarly to those of many municipal agencies. Normally, a budget request is submitted by a department and included, after possible modifications, in the proposed municipal budget, which is voted upon by the city or town council. Beneath that formal framework, support structures exist which connect an agency with its main constituents. As Aaron Wildavski notes approvingly in his study of the budgetary process,

... In the absence of strong central control over the various departments, each department is relatively free to seek improvements in its financial position by putting pressure on the [city] council. Clearly, in such a system, the advantage lies with the strong. [23, p. 131]

And the classic study of New York governance finds that

Without ... allies of weight and influence, without opportunities to form a broadly supporting public opinion, each Commissioner of Buildings is brought back, whatever his initial aspirations, to the necessity of a settlement with the groups whose activities he regulates. It is with them that he must make his peace. [15, p. 272]

For an empirical investigation of agency behavior and codes, an unusually good data set is available, collected in a 1970 survey of building codes by the International City Managers Association (ICMA) for over 1,100 American cities and towns, and described by Charles Field and Steven R. Rivkin [7], and Sharon Oster and John Quigley [13]. Additional data on housing construction and demographics originates with the Census Bureau Survey of Housing [18] and with the US Department of Labor [20, 21].

As a first step of estimation, the variables will be defined. The strictness of regulation, $R_i$, is described for each city or town by the extent that they include the 14 major restrictions that are listed by a Presidential Commission, weighted by their costliness $C_i$, $R_i = \sum C_i$. $C_i$ reflects the different economic cost of the 14 possible restrictions. They are derived from the figures found by the Douglas Commission, supplemented by the results of a survey of construction firms.

For a definition of the independence variable $I_i$, the formal legal status is not particularly meaningful, given the multitude of institutional arrangements across the country and the emptiness of the titular designation. It is far more useful to look at the components that constitute the elements independence. These include whether or not the appointment process is classified as political (versus internal promotion); whether the tenure of the agency head and staff is protected by a fixed term; whether the agency can set its own code regulations; whether the agency is insulated from elected politics by a city manager form of governance, and whether employees are secure through a civil service status.
Among the control variables, the strength of the two interest groups most directly concerned with building codes — construction firms and construction unions — must be considered, since it may have an effect on codes.

The regulatory policy of an agency may also be affected by the conditions in the housing market. Where shortages in housing supply exist, construction codes may be more liberal than where supply is plentiful. These conditions are given by the vacancy rate of housing and the construction volume per capita.

Furthermore, regulation in one locality may be affected by that of the surrounding area, for reasons of regional conditions and traditions.

The second set of equations explains the agency's "rewards" and investigates the hypothesis that these rewards are positively affected by the independence of the agency.

In defining "rewards" five alternative measures are used: the average salary of agency employees; the per capita budget of the agency; the increase in that budget; the salary of the agency head, adjusted for agency size; and the length of the job tenure of the existing agency head.

Foremost among the factors that must be considered for their potential impact on rewards is the local government's ability to pay, reflected by the median value of houses. Similarly, the prevailing industrial wages in the metropolitan region, the workload of employees (building permit applications processed per employee), and the educational attainment of the employees (years of schooling, professional experience at entry level) may affect budgets and salaries.

Using these variables, we can estimate Equations (1) and (2) by using a two-stage, least square estimation method. The results are given by Tables 1 and 2.

We first turn to the explanations of strictness in a building code. As can be seen in Table 1, this strictness is affected by strength of the interest group, construction unions. To a lesser extent, the housing market conditions appear also to make a difference. Importantly, all five attributes of independence of an agency — at the top of Table 1 — show both small and statistically insignificant coefficients. Thus, we find no support for the thesis that the presence of independence characteristics in a building agency is associated with a different regulatory policy than that associated with their absence.

If independence characteristics are not associated with a different regulatory policy, what are their effects on the agency itself? It has been argued in this paper that the status of independence confers some monopoly powers, which are translated into a higher reward in return for the supply of a regulatory policy. The results in Table 2 lend support to this hypothesis.

We find that four of the five measures of independence are statistically correlated with rewards. This is particularly true for the budget and salaries (both of the employees and of the agency head). Many of the coefficients of independence are statistically significant, or very close to it. The length of the tenure of the agency head and the increase in the budget are also well explained.
Table 1

Coefficients of Regulatory Strictness (2 - SLS results with Eq. (A))

<table>
<thead>
<tr>
<th>Variables</th>
<th>Variables</th>
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<tbody>
<tr>
<td>Agency head is political appointee</td>
<td>-.0585 (.5508)</td>
</tr>
<tr>
<td>Fixed term appointment</td>
<td>-.2351 (1.5962)</td>
</tr>
<tr>
<td>Agency sets its own code standards</td>
<td>.0178 (.6784)</td>
</tr>
<tr>
<td>City manager form of government</td>
<td>.1645 (1.5493)</td>
</tr>
<tr>
<td>Civil service status</td>
<td>-.1552 (1.7612)</td>
</tr>
<tr>
<td>Average Employee Salary</td>
<td>.0114 (.1833)</td>
</tr>
<tr>
<td>Construction union strength</td>
<td>.0018 (2.7660)</td>
</tr>
<tr>
<td>Construction firm strength</td>
<td>.2501 (.8487)</td>
</tr>
<tr>
<td>Vacancy rate</td>
<td>-.1306 (.1423)</td>
</tr>
<tr>
<td>Construction volume (in $ million)</td>
<td>-.0014 (1.1886)</td>
</tr>
<tr>
<td>Regional regulation</td>
<td>.7847 (7.83046)</td>
</tr>
</tbody>
</table>

\[ r^2 = .3430 \]

(t-statistics in parentheses)

by the results. However, the overall fit of these equations is not as strong as for the other three.

Among the variables for independence, a political appointment process yields a predicted negative sign with respect to rewards, while the security of a term appointment has a positive one. A city-manager form of government, which affords insulation from electoral politics—is associated with higher rewards.

The remaining variables control for other factors. We find that a locality's ability to pay affects budgets and salaries positively. Similarly, the professional qualifications of employees correspond to some rewards. But these "objective" explanations are supplemented by the independence variables.

This leads to the conclusion that the hypothesis of this article is unrejected. At least for building code regulation, there are no indications that independence provides regulatory outcomes that would not be forthcoming otherwise. However, the independence in agencies pays off handsomely for the agencies themselves. One beneficiary of building-agency independence, it seems, is not the public, or even the regulated industries, but the regulators.

NOTES

1. The classic discussions of independence are those of Marver Bernstein [2], R. E. Cushman [5], and F. F. Blachy and M. E. Oatman [3]. For a more recent view, see R. G. Noll [12].
2. This is admittedly not a conclusive proof about federal regulation. However, on the federal level there are rarely several agencies in charge or regulating the same activity, and hence different policies cannot be readily compared. (The concurrent enforcement of antitrust laws by the FTC and the Justice Department is an exception.)

3. For a thorough discussion of these codes and their enforcement, see Field and Rivkin [7] and Barry P. Keating [10].

4. Data made available by Francis Ventre of the National Bureau of Standards and John Quigley, both of whose help is gratefully acknowledged.

5. The code provisions are: Nonmetallic sheathed electrical cable; prefabricated metal chimneys; preassembled electrical wiring; wood roof trusses placed 24" apart; plastic pipe in plumbing systems; bathrooms or toilet continuous air space; single plates in nonloadbearing interior partitions; 2" x 4" of 1" in lieu of corner bracing; wood frame exterior walls in multi-family structures.

6. The weight for the cost of each restriction is based on the cost listing by the Douglas Commission [6, p. 271 ff]. Since these are incomplete for several of the restrictions, they are extrapolated in these cases by taking the ranking given to their importance by home manufacturers in a survey [7, p. 82], and using those restrictions for which both ranking and cost figures are known in order to estimate those for which only rankings are available.

7. Unless otherwise noted, data is from ICMA file, note 4.
8. The strength of interest groups is described by proxies. For the unions it is the percentage of unionized construction workers, normalized by the national average. Figures are from US Department of Labor [20, 21] and made available by John Quigley. For construction firms, it is the concentration ratio of construction firms, normalized by the national average. (Data by US Department of Commerce for SMSAs, made available by John Quigley.)


REFERENCES