



# The Takeaway

Policy Briefs from the Mosbacher Institute for  
Trade, Economics, and Public Policy

## Environmental Regulation

### Can government regulate itself?

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*What happens when regulators and the entities they regulate are both government agencies? Leading theories of regulation assume that governments regulate profit-maximizing firms: governments set rules, to which firms respond rationally in ways that constrain their behavior. However, often the entities that governments regulate are other government agencies, which face very different compliance costs.*

Many regulatory policies—especially health, safety, and environmental regulations—apply to government agencies as well as private firms. In the United States, tens of thousands of government agencies at local, state, and

federal levels provide a dizzying array of functions that are subject to regulation just like their private sector counterparts. However, government agencies and private firms confront different incentives and constraints in

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#### WHAT'S THE TAKEAWAY?

**Compliance with US environmental regulations is poorer among government agencies than similar private firms.**

**Environmental regulators respond to violations with less severe punishment against government agencies than against private firms.**

**Since the root causes of those differences are essentially political, the most effective solutions are likely to be political as well.**

the regulatory arena. Regulatory theory predicts that firms respond to regulation by weighing the cost of compliance against the risk of sanction for violation. Firms comply with regulations when the risk of penalties outweighs the cost of compliance.<sup>1</sup>

*Government managers are responsible to elected officials, voters, and professional peers, not shareholders*

Unlike profit-maximizing firms, government agencies face contested, ambiguous missions and are politically constrained from raising revenue to meet regulatory requirements. At the same time, agencies do not face direct competition from other firms, rarely face elimination, and may have sympathetic political allies. Consequently, the regulator's usual array of enforcement instruments (e.g., fines, fees, and licensure) may be potent enough to alter behavior when the target is a private firm, but less effective when the regulated entity is a government agency.

Conventional theories of regulation fit awkwardly when government agencies are the regulated entities for three broad reasons:

- Government agencies rarely have any kind of profit incentives. Government managers are responsible to elected officials, voters, and professional peers, not shareholders. They must balance regula-

tory mandates against competing priorities like equity, affordability, representativeness, and political responsiveness.

- Private firms may pass the costs of regulatory compliance on to consumers without serious threat to competitiveness, as long as other firms must also comply. Public agency managers must secure political support for the revenue increases, capital investments, and increased operating expenditures that regulatory compliance requires.
- Regulators are more limited in the penalties that they can impose on public agencies. Imposing a fine on a public agency penalizes the same public that the regulator serves. Threatening to shut down a public agency is not realistic if the regulated agency is a monopoly provider of some essential service. The US Environmental Protection Agency could hardly threaten to put the US Navy out of business for violating environmental regulations.

The ambiguity of agency goals and the difficulty of punishing noncompliance make the regulation of public agencies inherently political.

### ENVIRONMENTAL REGULATION

US environmental policy provides an ideal example to illustrate differences in public and private regulation outcomes because public agencies and private firms provide similar services, confront similar regulatory obligations, and are sufficiently numerous to provide statistical traction. We studied two prominent US environmental programs: the

Clean Air Act (CAA) and the Safe Drinking Water Act (SDWA). Both programs are administered by a single federal regulatory agency, the Environmental Protection Agency (EPA), and both regulate a large number of public agencies and private firms.

EPA regulation data on the two programs provided consistent evidence that publicly-owned facilities are more likely than similar privately-owned facilities to violate regulatory requirements under the CAA and SDWA. It also revealed a tendency for enforcement officials to impose less severe punishment on public agencies violating the CAA and SDWA compared to similarly non-compliant private firms. We found the following results<sup>2</sup> (also illustrated in Figure 1):

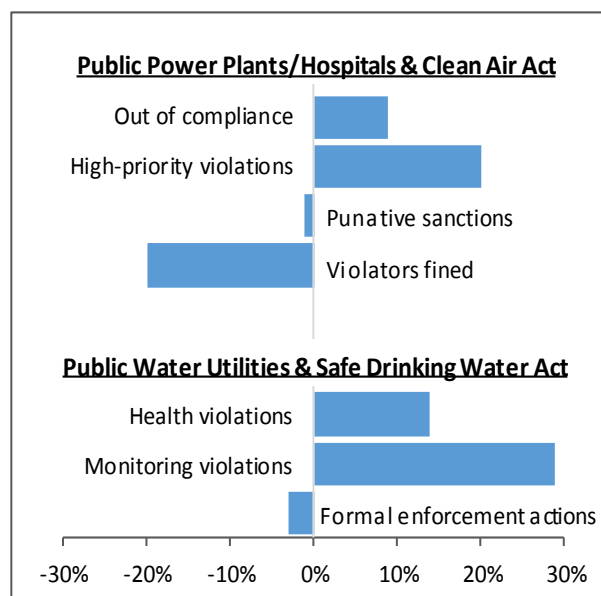
- Public power plants and hospitals were on average 9% more likely to be out of compliance with Clean Air Act regulations and 20% more likely to have committed high-priority violations.
- Among violators of the Clean Air Act, public power plants and hospitals were 1% less likely than private-sector violators to receive a punitive sanction and 20% less likely to be fined.
- Public water utilities had on average 14% more Safe Drinking Water Act health violations and were 29% more likely to commit monitoring violations.
- Among violators of the Safe Drinking Water Act standards, public water utilities were 3% less likely than investor-owned utilities to receive formal enforcement actions such as a citation and fine or administrative order.

## *Publicly-owned facilities are more likely than similar privately-owned facilities to violate regulatory requirements*

### **NARROWING THE DISPARITY**

It is not surprising that environmental policy implementation in the United States is uneven in ways that cause poorer compliance and weaker enforcement among government agencies relative to private firms. It is exactly what regulation theories predict. The difficult question is what can be done to make government regulation of government entities more effective.

**Figure 1: Percent Difference in Likelihood of Public vs. Similar Privately-Owned Facilities**



Source: US EPA CAA data (as of August 2012), SDWA data (as of April 2014) and authors' calculations

Solutions should address the extra challenges that public administrators balance, and since the root causes of those differences are essentially political, the most effective solutions are likely to be political as well. Potential responses could include subsidies for government compliance, stronger political leadership in regulated agencies, changes to regulator incentives, and privatization.

Greater transparency about the associated costs and challenges of compliance and non-compliance is also needed for both public and private entities. America's principal environmental laws are meant to protect the public from environmental harms, no matter their source. Nature doesn't discriminate between public and private sources of pollution, and neither should environmental regulations—after all, the health effects of pollution are the same whether the source is a government agency or a private firm.

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**Notes:**

<sup>1</sup> Viscusi, W. K., Vernon, J. M., and Harrington, J. E. (2000), *Economics of Regulation and Antitrust*. Cambridge: MIT Press.

<sup>2</sup> Konisky, D. M. and Teodoro, M. P. (2015), When Governments Regulate Governments. *American Journal of Political Science*. doi: 10.1111/ajps.12221

## ABOUT THE MOSBACHER INSTITUTE

The Mosbacher Institute was founded in 2009 to honor Robert A. Mosbacher, Secretary of Commerce from 1989-1992 and key architect of the North American Free Trade Agreement. Through our three core programs—Integration of Global Markets, Energy in a Global Economy, and Governance and Public Services—our objective is to advance the design of policies for tomorrow's challenges.

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