How Much Discretion for Agencies?
A Political-Economy Perspective on Risk Regulation[1]

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Very preliminary Draft. Comments most welcome.

Abstract: We explain Congress' choice between imposing rules on agencies and leaving them with more discretion on risk regulation. The optimal level of discretion results from a trade-off between the benefits of discretionary policies tailored to the particular expert information of the agency and the cost of having that agency implement policies that excessively favor the industry. Full discretion is optimal in contexts where risk regulation is efficient despite downstream moral hazard on the level of safety care undertaken by the firm. Partial (and sometimes no) discretion is optimal when solving the moral hazard problem downstream calls for leaving a liability rent to the firm. We show that less conflict of interests between Congress and the regulator, more uncertain environments, "higher" risks, all call for leaving more discretion to the agency. In several extensions, we study how this degree of discretion varies with the firm's technology, asymmetric information on the regulator's preferences and when the agency is strategically appointed by the Executive.

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