

Self-regulation and Meta-regulation – Regulating the Members or the SRO.

A Theoretical and Experimental Study*

Silvester van Koten**

University of Economics (VŠE)
University J. E. Purkyne in Usti nad Labem (UJEP)
CERGE-EI

Abstract

Regulatory investigations by Self-Regulatory organizations (SROs) are usually considered cheaper than investigations by a government. However, in practice, oversight by an SRO is mostly still supplemented by governmental oversight. The government may exert oversight over the SRO itself, a construction referred to as “meta-regulation” or “co-regulation”, or oversee members of the SRO. Indeed, the overall performance of SROs has been mixed, and theoretical models show that they have incentives to set lax standards or to cover up detected violations. Nonetheless, some research indicates that meta-regulation, oversight of the SRO itself, may not be necessary in some settings. Using a costly-state-verification model, DeMarzo et al. (2001; 2005) show that when the government implicitly threatens to conduct additional investigations of SRO members, a relatively “good” outcome can be established as an equilibrium. In this “good” outcome, the SRO chooses to follow high performance standards in order to pre-empt any (relatively costly) governmental investigation. As a result, no costly governmental investigations of the SRO members take place, and no meta-regulation of the SRO is necessary.

I extend this model to include plausible settings in which the actual rigor of oversight by the SRO can be verified only ex-post. I show that in such settings, an SRO may have incentives to announce stricter regimes than it effectively implements and that, as a result, a “bad”, Pareto-inefficient outcome may be established as an equilibrium. In the “bad” outcome, the SRO relinquishes all oversight to the government. The predictions of this model are supported by experimental tests. The “good” equilibrium could be re-established with sufficient meta-regulation of the SRO. The results thus suggest a continuing need for meta-regulation in these settings. This form of meta-regulation may be of a relatively light nature, limited to verifying and sanctioning that the SRO implements its announced policies.

Keywords: Self-regulatory organizations, meta-regulation, co-regulation, regulation, governmental oversight, simultaneous versus sequential games, costly state verification.

JEL Classification: C72, G18, G28, K20, L44

* I thank Andreas Ortmann for comments on earlier versions. All errors remaining in this text are the responsibility of the author. Support from the IGS research grant 72/2017, from institutional support RVO 67985998 from the Czech Academy of Sciences, and from GEMCLIME (681228) is gratefully acknowledged.

** Associate Professor at the University of Economics (VŠE), Department of Economics, Churchill Square 4, 13000 Prague, Czech Republic. Email: Silvester.VanKoten@vse.cz. Senior Researcher at the University J. E. Purkyne in Usti nad Labem (UJEP), Department of Social Economics. Visiting Researcher at CERGE-EI, a joint workplace of Charles University and the Economics Institute of the Czech Academy of Sciences, Politických veznu 7, 111 21 Prague, Czech Republic.