



# **Regulatory Capture Theory and Its Relevance to the Nigerian Situation: A Case Study of National Agency for Food and Drug Administration and Control (NAFDAC)**

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## **ABSTRACT**

Regulatory capture happens when a regulatory agency formed to act in the public's interest, eventually acts in ways that benefits the industry it is supposed to be regulating, rather than the public. This paper explores the Regulatory Capture Theory and its Relevance to Nigeria, using National Agency for Food and Drugs Administration and Control (NAFDAC), an agency that is charged with the responsibility of regulating food, drugs, chemicals, confectionary, cosmetics and related items, as a case study. The paper also examined the basis of Regulatory Capture Theory, Forms of Regulatory Capture and Criticism of the Regulatory Capture Theory. The paper juxtaposes the Regulatory Capture Theory and National Agency for Food and Drug Administration and Control (NAFDAC) behaviour toward regulatory policy. The paper recommends among other things that there should be adequate funding of regulating agencies in Nigeria in order to make them resist the temptation to accept gifts or any kind of sponsorship by regulated industries so as to be able to carry out their regulatory responsibility efficiently and effectively.

**Keywords:** Regulatory Capture, Regulatory Agency, Public Interest, Industry

## **INTRODUCTION**

In the social sciences in general theories are intended to act as intellectual beacons to help illuminate phenomena, provide understanding, explain events and predict social outcome. Regulatory theories are propounded to help understand, explain and predict the behaviour of regulatory agencies (Olugbena, 2013). Mitnick (1980) opined that theories of regulation are important because they help us to understand the functions of regulation, predict situations where it is most likely to be effective, and evaluate the outcome of regulatory policies. A good theory should explain each stages in regulation process, from the time a potential regulation is proposed, through its adoption, implementation and enforcement.

In practice, however, regulatory agencies have delegated powers. They are thus subject to agency problems, and regulators are subject to economic incentives that can encourage them to make decisions that are not wholly consistent with the interest of the society, favoring the interest of firms in the regulated sector instead. When this occurs, we have regulatory capture, which can be defined as a process by which regulated firms influence and manipulate the decision of the authorities that supposedly supervise the economic activity developed by them (Dal Bo, 2006).

Regulatory capture is a form of government failure that occurs when a regulatory agency, created to act in the public interest advances the commercial or political concern of special interest groups that dominate the industry or sector it is charged with regulating.

Regulatory capture is also referred to as social capture. According to Fisher and Lovell (2003), it arises when a mechanism e.g. a committee, a regulatory body or a political process, which is established to oversee a particular facet of social life, but which becomes dominated by or influenced by, the very sectional interest the mechanism was intended to monitor or control.

Furthermore, regulatory capture is construed as Life-Cycle theory of regulatory agencies. According to Estache and Martimort (1999), this suggests that just as a product in the market, a new regulatory agency undergoes a Life-Cycle when established during regulatory reform, the agency is subject to close scrutiny

by the government and even by the general public, but by the time the attention focuses on other topics and the day-to-day activities of the regulator are less in spotlight of public attention. While at the beginning the regulator faces strong pressures to effectively play its role as protector of users against the industry, this pressure decreases with time while the pressure by the industry remains constant. With this evolution, the regulator becomes more prone to be dominated by the interest of the regulated firms. The above is evidence in Nigeria. Most regulatory agencies and bodies in Nigeria seem to be active in the early years of their establishment, ensuring strict and substantial compliance with the established rules. As they grow old they tend to be dominated by the industry.

### **The Regulatory Capture Theory**

The regulatory capture theory is an antithesis to the public-interest theory. While the public interest theory argues that regulation is instituted in the public interest, the capture theory proposes that regulation serves the interest of the regulated industries. In a sense, the theory argues, the regulator is captured by the regulated and that the loser is the public who, ordinarily should benefit from regulation.

Regulatory capture is a theory associated with George Stigler (1975), a Noble Laureate economist. Other scholars that have extended the frontiers of the theory include Duncan Black (1948), James Buchanan and Gordon Tullock (1962), Mancur Olson (1965,1982), Kolko (1968), Lowi (1969), among others.

The theory of regulatory capture has evolved into several versions. Yet, it is common to all of them that regulation is a process by which regulatory agencies eventually come to be dominated by the very industries or sectors they were charged with regulating. In order words, is a process by which interest groups seeks to promote their private interest. One version of this theory stems from political science, particularly from the works of Bentley (1908) and Truman (1951), who emphasize the importance of interest groups in shaping public policy. In this analysis it is expected that a specific interest group “the regulated firms” prevails in the dispute to influence the legislation, the original objectives of a regulatory process fade through lobbying by interest groups. Overtime, regulated firms gradually gain control over the agencies that regulate them.

In a more theoretical approach, regulatory capture occurs when groups of individuals or firms that, having an interest in the outcome of regulatory policy decisions, direct their efforts and affect their resources in seeking to achieve the desired outcomes of those policies. At the same time, ordinary citizens, each with only a marginal interest in these policies, show no great concern in influencing their determination.

In this context, it is possible to establish more precisely the concept of regulatory capture, which is connected to success in influencing or capturing regulatory agencies, so that policies and legislation preferred by firm are implemented.

### **Forms of Regulatory Capture**

There two forms of regulatory capture that can be distinguished. These are the ex-ante capture and ex-post capture.

An ex-ante capture is defined as the set of influences that are exercised in the process of defining the rules and regulation ie this type of capture occurs when regulated firms are able to influence

the legislation and regulation to their benefit, before it takes effect. However, the ex-ante capture is also carried out at a more operational level, with the same objective – to obtain higher gains.

The ex-post capture seeks to influence regulatory agencies with the goal of avoiding compliance with existing rules and regulations, possibly through bureaucratic corruption. This type of capture may also involve legislature corruption if the influence exerted seeks to change existing laws and rules through renegotiation processes that favours the regulated industry.

There are two fundamental ways or means by which the industry or regulated sector captures the respective regulatory agencies. These are:

1. The Materialistic Capture or Financial Capture. It occurs when the motivation of the regulatory agent is of material nature, and may result from bribes, contributions and political donations, or from the desire to maintain a high level of funding by the state.
2. Non-Materialistic Capture which is also called cultural capture is evidenced when the regulator begins to think like the firms in the regulated sector, reflecting a strong social identification with it. In this case the regulator is not materially corrupted; it accepts the influence, values and interests of regulated firms, which he believes are convergent with the interest of consumers and society.

### **The Basis of the Capture Theory**

The capture theory, particularly its ex-ante variant, indicates that from the onset, regulation was never intended to serve the public but to benefit business. As Kolko (1968) cited in Olugbenga (2013) argues, from the beginning of the twentieth century, American industries have influenced proposals on regulation from drafting, adoption to implementation – by the new regulatory agencies.

Lowi (1969) cited in olugbenga (2013) offers an explanation for this development. According to him, modern government is intimately connected with the rise and success of private power. In addition, he argues that rule making and administration have changed during the course of the twentieth century from that of rigid rule setting for all to follow, to that of discretionary rule making and application for particular groups and interest. Several issues that were once presided over by the legislature have been delegated to regulatory agencies, ministries, boards and commissions that often give in to pressure from powerful interest groups that attempt to influence policy. According to him, this is a strategy to “parcel out to private parties the power to make public policy”. In this and several other ways, he argues, private interests dominate government and perpetuate privilege over equality. The capture theory postulates that this is the situation with regulatory agencies. A review of the literature suggests that this could be due to several factors.

1. The condition of Asymmetric Information. Regulated industries have an information advantage over their regulators. Lane (2000) puts the question rhetorically:” who knows the exact shape of the cost curves in an industry? What about elasticity of demand? ... the regulator is dependent upon those regulated to provide them with basic information as they act within the confines of bounded rationality ... the regulator can only use indicators that are at best fairly reliable tools but at worst carry simple straightforward erroneous information. This is more so because much of regulation relies on voluntary compliance and reporting of data by the regulated, which often have monopoly of information.
2. The regulated can increase their control over the regulators in certain ways. For example, Fraleigh, Gerston and schwab (1988) argued that public officials are bribed, although such gross persuasion is seldom necessary. Subtler ways of influencing the regulatory process include exploitation of mutual interest between the regulated and the regulatory agency through mutual membership of professional associations. Another avenue for influencing regulators could be mutual membership of investors’ fora in particular industries.

3. There is no credible motivation for the regulator to begin to look very closely into a sector of the economy that is regulated as long as the regulated can disclose information that puts it at advantage and in which the regulator can prohibit all manners of opportunism, both in terms of product quality and price. Indeed, Mueller (1989) has argued that: personnel in bureau are in reality not the unselfish servants of their political masters, devoted to the neutral and objective fulfillment of a vocation. Quite the contrary, public administrators fulfill their duties out of selfishness, reducing the public goals of the status of a means in relation to more basic personal objectives such as pecuniary reward, personal power and prestige as well as security of employment.

### **Criticism of Capture Theory**

Even though the capture theory presents somewhat more pragmatic analysis of regulatory behaviour, critics still argues that it is one dimensional, revealing very much the problem of agency capture. However, the case is such that most regulatory agencies are designed to represent a variety of constituents that includes both the public and the regulated. For instance, Peltzman (1976) argues the fact that agencies are “public” means that through a variety of procedures (such as hearings and investigations), public opinion will be considered or incorporated in the regulatory decision-making process. He concludes that capture theory as a whole fails to consider the diversity of interests represented in the regulatory process.

Meildinger (1992) submits that the popularity of the capture thesis and its criticism have contributed to substantial changes in the structure of modern regulation (such as the expansion of participation, judicial review of regulatory decisions and enforcement rights by regulatory beneficiaries). However, some critics still argue that those changes have served primarily to legitimate regulation further, rather than to alter its effects (Offe, 1976). On the suggestion that powerful economic and political interests often dominate the regulatory arena, it is argued that these developments should not be feared because they are checked in the market place (Gerston, Fraleigh and Schwab, 1988).

### **Regulatory Capture Theory versus NAFDAC Behaviour in Regulation Policy**

National Agency for Food and Drugs Administration and Control (NAFDAC), is an agency that is responsible for the regulation of food, drugs, chemicals, confectionery, cosmetics and related items.

Using the regulatory capture theory, we shall be examining the behaviour of NAFDAC as a regulatory agency by looking at three NAFDAC policies in regulation with a view to understanding how well the policies and their implementation agree with the basic postulations of the capture theory of regulation.

*Case 1: The banning of the use of Potassium Bromate as an Improver in Bakeries and the Confectionery Industry in General by NAFDAC.*

Bakers and confectioners are known to use several supplements and conditioning agents as improvers of dough to increase its strength during mixing, extensibility for moulding and also to increase loaf volume and texture. According to NAFDAC, studies have shown some of such improvers and reagents to be deleterious to the health of the public. Because of its worry over the harmful effects of potassium bromated on the health of the public, NAFDAC has banned the use of this oxidizing agent in spite of the fact that it is cheap and probably the most effective in its category. The British Ministry of Agriculture cited in (Akuyili, 2005) has argued that:

*Concern has been expressed on the harmful effect of potassium bromated. Toxological studies have convincingly shown that potassium bromated affect the nutritional value of bread by degrading vitamins A1, B1, B2, E and niacin, the main ingredients in bread.*

Also, the British Food Manufacturing Industries Research reported in 1980 that potassium bromated destroys folic acid in solutions in 10 days (cited in Akunyili, 2005). Furthermore, research findings by Kurokwa, et al (1982) and Quick, et al (1975) (cited in Akunyili, 2005) have confirmed that flour and bread treated with bromated proved carcinogenic on oral administration in rats.

Finally, the International Chemical Safety Cards (ICSC) reported that potassium bromated causes cough and sore throat when inhaled. When ingested or taken orally, either directly or indirectly, it causes abdominal pain, diarrhea, nausea, vomiting, kidney failure and loss of hearing. Other effects are redness and pain both in the eyes and skin (cited in Akunyili, 2005). This is apart from the fact that it causes cancer and breakdown of essential in bread and other bakery products. Other improvers that are injurious to health include ammonium persulphate and nitrogen dichloride. Due to the above reasons, the Food and Agricultural Organization in collaboration with and removed potassium bromated from the list of improvers generally regarded as safe (GRAS). In conformity with the FAO/WHO Committee decision, NAFDAC banned its use in flour milling and baking in Nigeria in 1993.

By banning the use of potassium bromated in bakeries and the confectionery industry, NAFDAC evidently intended to protect and safeguard the health of the public. However, after series of public enlightenment campaigns and consultative meetings between NAFDAC officials and millers/bakers, and after giving them a two-month moratorium within which to comply, NAFDAC destroyed “thousands of loaves of bread... and many bakeries were closed down” (Akuniyi, cited in Oyedeji, 2004). That is expected of a result-oriented regulatory agency in an environment like Nigeria. However, in a sudden turnaround that suggests that some other interests might be at play, the Director-General noted that:

*NAFDAC found it insensitive to continue to destroy such large quantities of bread or to close down most bakeries considering the nature of services rendered to our teeming population and also the economic implications...again; we stopped enforcement (Akunyili, 2005).*

The agency found it more convenient to allow Nigerians to be fed with poisonous substances while unscrupulous businessmen made fantastic profits on the people because they rendered certain ‘important service’ to citizenry. Rather than enforce relevant laws and regulations that can guarantee the high quality and safety of products, the agency was contented with appealing to bakers and millers to comply, even after refusing to do so for about two years. Whatever might have been the reasons behind the actions of the agency, it clearly suggests a validation of the capture theory, as it did not promote the good health of the consuming public.

**Case 2: NAFDAC's Proposal to Establish Drug Marts across Nigeria.**

The idea of establishing drug mart across Nigeria was aimed at sanitizing the chaotic drug distribution network in Nigeria that is dominated by charlatans, a situation that has led to the preponderance of fake, adulterated and expired drugs in the country, with adverse consequences on the health and productivity of the citizenry. According to the NAFDAC Director General, the plan was to achieve maximum effective regulation within the shortest time possible (Akunyili, cited in Oyedeji, 2004). The plan was to be achieved by closing exiting markets operated mainly by sellers of fake drugs and other charlatans and replacing it with drug marts that would make government regulation and control of the drug business more effective by facilitating more thorough checking and monitoring of drugs and medication coming into the Nigeria market, either from local or foreign pharmaceutical companies.

During the planning of the programme, NAFDAC had consulted with the National Assembly and other stakeholders, particularly the Pharmaceutical Society of Nigeria (PSN). Whereas the

National Assembly saw the merit of the drug mart idea and decided to commit 800 million Naira to it during the 2001 and 2002 financial years, the Pharmaceutical Society of Nigeria and other drug dealers initially supported the idea but later antagonized it. Eventually, the programme was aborted.

In explaining why the programme was aborted the Director General said that:

*regulating the market was like swimming against the tide- it was a bundle of confusion. It was not organized; many of the shops are run by charlatans... We called the pharmacists to Oshodi and explained to them: in fact the architect showed them the design, and some made suggestions like the inclusion of a book... (Later) there was an attack on the agency-NAFDAC-with headlines like "Drug Mart? Is it their business?" and the fight was so much that we had to re-invite the pharmacists again. There we told them all over again of the aims of the drug mart. They seemed to agree but after each meeting, the fight became greater. So, one day my loved ones called me and said I am fighting drug barons...later my management had a meeting and the issue of the drug mart was closed (Akunyili, cited in Oyededeji, 2004).*

### **Case 3: Inspection of Baby Food and Hotel Businesses**

NAFDAC inspects the fast food and hotel businesses to ensure that food served to members of the public contain the right ingredients, in the right proportions and that they are not in bad conditions, adulterated or expired. This is all in a bid to safeguard the health of members of the public. In 2004 NAFDAC inspected a hotel, made discoveries of expired canned food that should have warranted an alarm to warn members of the public about eating in such a place, but kept quiet because of some other considerations.

According to the Director-General:

*We inspected a top hotel recently. We did not want to destabilize the system by raising an alarm because we found an expired baking beans and processed foods- all these are used in most restaurants except 'mama put' (bukateria)- I mean processed tin tomatoes, expired food items. It was difficult for us not to raise an alarm because should we raise an alarm where we have mostly foreigners, one will destabilize the system. Those may further raise an alarm in their countries. Regulation is not easy. What we do is dashed out information that would not further cause panic to the public (Akunyili, cited in Oyededeji, 2004).*

Contrasting the action of NAFDAC in that circumstance with its action in another instance where the agency found expired baby milk on display for sale, the Director General noted:

*We could not hide that of the baby milk: it is criminal. But with that hotel, it was made to pay a fine with a strict warning that if it happens again, even if it is the biggest in Africa, it would be closed down (Akunyili, cited in Oyededeji, 2004).*

In this case it was abundantly clear that NAFDAC failed to perform up to expectation by keeping quiet when it should have raised alarm to warn the public over the use of expired processed food in the hotel. By refusing to raise alarm NAFDAC did not protect the public interest but rather the

agency was more interested in generating revenue for itself and protecting the profit maximization tendencies of the hotel.

## CONCLUSION

Regulation exists to correct the negative effects of market failures, on the well-being of consumers and of the society at large. However, the achievement of regulatory objectives can be hampered by the existence of interest groups that seek to condition regulatory action so that regulators can make decisions favourable to the goals of these interest groups.

It is pertinent to recognize that different interest groups influence the regulatory process.

From the above cases mentioned it becomes abundantly clear that the regulatory agency occasionally end up being captured by the very industries it is supposed to regulate. This occur as the regulated court their regulator who over time, learn to adjust to the desires of the regulated through the instrumentalities of bribery, mutual membership of professional associations and investors' fora, lobbying etc. There is need to put in place mechanism and incentives that make public interest more active in the regulatory process and in negotiations between regulatory agencies and regulated industries.

## RECOMMENDATION

The paper recommends as follows:

- That there should be adequate funding of regulating agencies in Nigeria in order to make them resist the temptation to accept gifts or any kind of sponsorship by regulated industries so as to be able to carry out their regulatory responsibility efficiently and effectively.
- The welfare package of the staff of regulatory agencies should be improved in order to avoid the temptation by them to ask and accept inducement from regulated firms.
- Regulatory agencies should have clear missions, promote transparency and participation of the various interest groups in public discussion and negotiation
- Regulatory agencies should be allowed to enjoy autonomy and be independent of external control.
- Regulatory agencies should to develop new ideas that are aimed at encouraging voluntary compliance by regulated firms.

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