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Abstract

The last quarter of a century has seen two broad waves of regulatory reform. The first wave, which

Netherlands and Germany. The development of a ‘regulatory state’ in Europe, both at the European Union level and among its member states, involved not only de-regulation, but a considerable degree of re-regulation as more or less independent regulatory authorities replaced public utilities as the dominant instrument for regulating markets (Majone 1994; McGowan & Wallace 1996). Consequently the debate turned to how to design and control the regulatory authorities, and particularly to the question of independence. The second wave of regulatory reform that began in the mid-1990s is both more modest and more subtle than the previous programs of deregulation (Sørensen & Dalen, 2001). The modesty lies in the realization that politically it is unrealistic to do away with large bodies of regulatory legislation. Its radical subtlety follows from the combination of privatization and reregulation as the principal pillars of regulatory reform.

Regulatory reform at the millennium acknowledges the institutional and administrative aspect of regulatory policy. Since regulatory policy has to be implemented by administrative authorities, reformers have asked what the proper design of these regulatory authorities is. Have they to be integrated into the executive hierarchy? Or should specialized authority be delegated to administrative bodies that enjoy some or full autonomy vis-à-vis the executive hierarchy? Should the final appeals authority be political, in the shape for example of a minister, or should it be judicial? The institutions in question include central banks, government regulatory agencies, corporative institutions as well as specialized courts. This paper focuses on the administrative and organizational aspect of the new wave of regulatory reform.¹ The starting point is a brief summary of recent literature on this topic. We start out with a brief review of the normative or ‘public interest’ theory of regulation, and contrast this with an overview of the positive or institutional theories. This theorizing forms the basis for our (preliminary) discussion of the empirical studies on independent regulatory agencies, notably the actual autonomy of different regulatory agencies.

2. A new research agenda

The changes in regulatory policy are paralleled by a similar change in the research agenda. Whereas the 1980s saw very dynamic political science research on governmental regulation and the political

¹ This paper is part of a larger project of delegation and agency organization within the field of regulatory policy. Here the perspective is narrowed to a critical review of the arguments and inferences that are often made in the booming literature on regulatory reform and administration. In particular the focus is on the organization and role of independent regulatory authorities.

programs for de-regulation, the realization that consistent implementation was usually problematic set the agenda for a redirection of research on regulatory reform. Re-regulation turned out to be the realistic alternative to deregulation, as well as the strategy for regulatory reform (Vogel, 1996). Simultaneously, other real world phenomena prompted the development of a new research agenda. Large-scale privatizations raised new issues as to political motives, strategy and procedures, impact and policy adaptation. This was particularly evident in countries like New Zealand and the UK, which emerged as the international frontrunners for regulatory reform (Baldwin & Cave, 1999; Duncan & Bollard, 1992; Feigenbaum, Henig, & Hamnett, 1998; Moran, 2002). Developments in the EU created another, quite different, impetus for changing the research agenda. The European internal market is part of a large-scale regulatory challenge to legislative systems and regulatory authorities that had in the past been relatively closed to outside influence. This raised a series of new issues concerning the organization of the authorities responsible for the administration and implementation of joint regulatory policies. The question of credibility was particularly prominent on this new the EU-level agenda, and it presented a challenge to vested interests at the national and sub-national levels (Jabko, 2004; Majone, 2000). The result has been a growing and dynamic literature on regulatory reform and administration, and the evolution of a common understanding about the central aspects of regulatory reform and administration. These recurring themes and claims are briefly summarised below, and provide the point of departure for this critical review.

Much of the literature considers the use of non-majoritarian institutions and independent regulatory authorities as, for all practical purposes, a relative new phenomenon (Gilardi, 2005; Levi-Faur, 2005). This is particularly the case in Europe, where regulation was relatively unimportant in the past, and regulatory administration was routinely the responsibility of authorities that were an integral part of the executive hierarchy and therefore ultimately reported to government ministers. This comparison of past practice with modern reform is contrasted to the American tradition, where governance is seen as strongly rooted in the particular US public policy tradition. Federal independent regulatory commissions are cited as evidence that regulatory policy was delegated to non-majoritarian institutions and independent regulators at a point in time when such ideas were foreign to European policy-makers.

With the establishment of this historical difference, the scholars that have contributed to this new research make two generalized observations. One is that the use of NMI/IRAs is a phenomenon that is specific to economic regulation, i.e. the regulation of business and market activities in the private sector (Gilardi, 2002 & 2005). The second generalization reports the increased reliance on NMI/IRAs in Western Europe (actually around the globe) is the result of a process of diffusion where policy-makers are inspired by well-trying and comparatively efficient forms of regulatory administration in the USA, which they consequently import (Gilardi, 2005; Levi-Faur, 2005). These ideas have not only gained currency in the academic world, but also among practitioners. The OCED has become heavily engaged in furthering regulatory reform, and its work draws on has become part of the academic research agenda.

This summary is much too brief to do full justice to the creativity, theoretical and analytical sophistication that lies behind the new research agenda within regulatory policy and administration. To us there is little doubt that it has contributed to improved understanding of governmental regulation and reform. To us the

3. The normative theory of regulation: Credible commitment

Economic - normative theories of regulation generally take the 'public interest' as point of departure. They are normative in the sense that they focus on the institutions that ought to be designed, and functional inasmuch as they focus on the requirements necessary to secure a degree of economic efficiency. This literature seeks to identify the conditions under which decisions should be taken by agencies subjected to direct control by elected politicians, and when decisions should be delegated to so-called independent regulatory agencies (IRA). Such agencies make decisions on basis of relatively generalized legislation, leaders are non-elected administrative officials, and elected politicians cannot reverse or modify their decisions. The public interest theory identifies characteristics of the policies or issues that warrant delegation to (more or less) autonomous agencies. The first set of qualities relates to the inability of laymen to make proper decisions. Regulating sectors like telecommunications and mass communication, energy, transportation, financial markets and general competition policy is highly complex. Regulation of e.g. workers' health and safety, pharmaceuticals and food safety raises issues that entail the same combination of technical complexity and political saliency. Task environments are generally heterogeneous and unstable, and the potential effects of alternative policies are inherently uncertain. Politicians need to call in trained experts to design and implement regulatory policies in economic as well as social sectors. However, this justification does not in itself require watertight isolation of administrative agencies from political influence. It merely suggests that experts will make highly technical decisions, and it seems hard to see how elected politicians could gain from interfering with the specifics of regulations or case decisions. In other words, the establishment of proper IRAs would need a better explanation. Two forms of the need for credibility have been invoked by both economists and political scientists.

The first problem related to credibility concerns consistency over time. Temporal inconsistencies occur in situations where a player's best plan for some future period will not be optimal when that future period arrives. The prime example is monetary policy. Governments are best off designing a plan involving low inflation today and tomorrow. Yet politicians cannot credibility commit to this strategy, since low inflation may have negative effects in the short run. Governments are not subjected to a higher law (they make legislation), and cannot be penalized (by legal means) for

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is why independent central banks can improve the credibility of a low-inflation strategy and improve macro-economic performance. This argument does *not* assume opportunistic or vote-maximizing politicians; it merely assumes that elected representatives are benevolent agents who may adjust their plans, priorities or objectives as time goes by. They may of course also try to improve their electoral chances by engineering inflationary booms prior to elections, but even if they refrain from such vote-maximizing, their policy promises are not particularly believable. An independent central bank, with a fixed mandated target of price stability, can therefore run a more credible monetary policy that contributes to economic stability.

The second credibility problem concerns opportunistic politicians. The normative theories discussed briefly above assumed that government regulations were designed to further the 'public interests' (for a review, see Peltzman 1993). Regulations should and did ensure that prices were set at marginal cost, and natural monopolies warranted public (monopoly) utilities. Stigler's (1971) contribution challenged this orthodoxy. Politicians can face incentives to act opportunistically, and pursue narrow goals that benefit special interest groups. Elected politicians may design general regulations that further the intere

In either case, entrepreneurs make investments in a long-term perspective, and therefore need assurance that regulatory provisions in force at the time of decisions will also be respected in the future. If regulatory policy is reversed due to short-term political incentives, investors will be reluctant to engage in long-term projects and contracts. This argument is relevant for legislation, the administration of legislation in force, and to the rulings passed by the judiciary. It is also the basis for advice as to the design of regulatory institutions: as far as possible, politicians should not be permitted to interfere with particular regulatory cases or interfere with the management of government owned companies as they have incentives to cater for special interest groups. This view shaped the European Commission's reports on the accession countries' progress towards qualification for full EU membership in the years running up to 2004, when regulatory agencies' actual independence from the executive and their available resources were at the core of many of the Commission's assessments (CEC 1998-2004).

4. Political theories of regulatory institutions

The reasoning set out above informed the prevailing understanding of government regulation during the 1980s and most of the 1990s. Its theoretical limitation is obvious – it has very little to say about the political motives for regulatory organization. First, any rational policy-maker – benevolent or otherwise – will see the need for delegation in situations of complexity and heterogeneity. Second, only a benevolent politician will recognize governance problems of time inconsistency. However, we must consider the possibility that that elected politicians seek other goals than regulation in the public interest. Third, and most important, therefore, if politicians act to further their short-term re-election prospects when making regulatory decisions, does it follow that they recommit by 'tying themselves to the mast' and establish autonomous agencies? Regulatory institutions are not explained in terms of political motives; we know little about the role that such institutions may play in the competition for voter support. Fortunately, some new theorizing has evolved during the last decade or so.

The first set of models that take politician's motives into account but go beyond the regulatory

alternative regulations. Whereas Stigler had suggested that industry could acquire (or buy) regulation from politicians, Peltzman (1976) proposed that they might also seek to use regulation to increase popular support. Assuming that voters are informed, regulation would therefore be a balance between consumer and industry interests as politicians take into account both consumer welfare as well as producer interests. Arguing along similar lines, Becker (1983) suggests that the dead-weight costs of regulation (which harms society at large) will constrain the extent to which regulation can be used to inhibit efficiency. He claims that ‘... policies that raise efficiency are more likely to be adopted than policies that lower efficiency’ (Becker 1983:384). Alternatively, we may conjecture that voters are imperfectly informed about the effects of alternative regulations, which paves the ground for various forms of regulatory capture and political opportunism. Suppose, however, that voters recognize this limitation of party competition, but also realize that there is a potential for imposing institutional constraints on their elected representatives. We would then expect parties to offer voters independent regulatory institutions that yield the best social and economic welfare. This is the ‘benchmark’ model – knowledgeable voters impose tighter constraints on political competition, regulatory policy and possibly also institutional design.

This interpretation takes for granted that regulatory independence is possible. Yet it is hard to envision a fully independent government institution. Even courts require budgetary appropriations, judges must be appointed and their decisions can be subjected to public criticism. It is an empirical question (to be addressed below) whether institutions are sensitive to the short-term vote-maximizing interests of the majority party. Moreover, there is a substitute for formal institutional independence, namely the use of information to build a reputation for fair, impartial and professional decision-making. Central banks have pioneered extensive transparency to establish credibility. In the UK Clarke argues that it was his decision as Conservative finance minister to publish the minutes of his meetings with the Bank of England (with a one-month delay) that was the key threshold on the way to the banks independence, rather than the formal independence his successor granted the Bank after the Labour victory in 1997 (Clarke 2004). The procedure made it very transparent when the finance minister over-rode the Bank’s advice, and he could be held accountable by voters for any subsequent mistakes. Similar evidence is found for regulatory authorities that have more specific mandates to implement and monitor regulatory policies. Both the Danish Competition Authority and the Financial Supervisory Authority of Norway have a long tradition for openness and transparency in their decision-making. The same applies to some, but by

no means all, of the recently established or reorganized authorities that are responsible for utility regulation. A comparison of the Danish National IT and Telecom Agency with the agency responsible for the regulation of the market for railway operations (the National Rail Authority) is telling in this respect. To the extent that an institution has established a reputation that serves policy well, it will be costly for elected politicians to interfere in particular cases for short-term benefit. An

politicians a basis for remaking legislation or changing institutions. Whether these forms of control are efficient or not remains an empirical issue.

However, a third set of models challenge the assumption that party competition is efficient, which is prevalent in the literature discussed above. If party competition is not efficient, it might not force politicians to seek the best institutional designs available. Various types of information problems may induce politicians to choose organizational forms that serve purely political goals, but not necessarily efficiency or democratic controls. The 'blame-shifting model' (Fiorina 1982, Christensen & Pallesen 2001) suggests that politicians wish to claim credit for successful policies, but renounce responsibility for policy failures. Since it is impossible to identify successful policies in advance, institutions should allow executive politicians both options (claim credit/evade responsibility). This calls for semi-independent institutions where political responsibilities are ambiguous. For example, formal independence and board supervision underscores agency autonomy. Nevertheless, the minister may retain the opportunity to reverse a decision on appeal. A frequent operation of such procedures is likely to have detrimental effects on administrative motivation and performance (particularly when minister shift the blame onto agency executives), and they also will weaken citizens' capacity to hold governments responsible. Again Britain (in 1995) provides a text-book example in the conflict between the Conservative Home Secretary Michael Howard and Derek Lewis, chief executive of the Prison Service which had been an executive agency since 1993, over who should take responsibility for prison escapes. The minister sacked the chief executive, but the government settled the resulting court case out of court amid much public controversy (Barberis 1998). Such effects can be interpreted as an unintended effect of semi-independent regulatory institutions, or as a deliberate strategy to inhibit electoral controls.

prompts spectacular policy failures (Dunleavy 1995, Moran 2001). The main constraints are fears of possible consequences in the form adverse effects on the tax base or of punishment by voters come the next election. In contrast federal systems that require the assent of two chambers or several branches of government to new legislation makes revision of regulatory regimes all the more difficult, and institutional 'lock-ins' more tempting. Germany's 'joint decision trap' is a case in point (Scharpf 1988), as it makes economic reform particularly laborious. The Scandinavian systems lay somewhere between these two extremes. Scharpf's analysis also covers EU politics, and particularly the treaty changes (or constitutional politics) where the member state's unanimous agreement is required. Much the same applies to international organization that can only review their rules by unanimous agreement, and the only choice other than the status quo may be to exit the organization.

The political system of the European Union epitomizes some of these issues of regulatory politics. It is even more of a 'regulatory state' than most of its member states, and with a few important exceptions (such as agriculture and regional policy) it relies almost wholly on regulation and law rather than economic distribution. The Commission acts like an independent regulator, and particularly its Directorate General for Competition is often seen almost as an independent federal cartel office in itself (Wilks 1992; McGowan & Wilks 1995). The 'joint decision trap' lies partly in the lock-in of the institutional set-up agreed unanimously by the member states, and partly in the difficulty even of revising (or agreeing) policy decisions (Pollack 1996; Scharpf 1999). Although the national level actors' time horizons may be short and 'national interests' change as and when governments change, both policy agreements and institutional arrangements tend to persist. Any single member state can prevent changes to the EU's competition rules, and the system has survived successive treaty revisions. As for policy decisions, the provisions for qualified majority voting in the Council of Ministers and absolute majorities in the Parliament allows minorities to impede revision once rules have been agreed. It has therefore so far proven very difficult to revise agreements on utilities liberalization, and this situation could persist even if a majority of member states were to demand change (to be sure, EU law says relatively little about how the key regulators in the sectors, which operate at the national level, should be designed). Likewise, revision of the Growth and Stability Pact, which establishes operational parameters for the Euro-members deficits, proved particularly acrimonious. At the only occasion when the Pact had effectively been violated, by Germany and France, all the states concerned were very quick to agree its revision.

Yet as far as EU institutions are concerned it is difficult to establish whether the rules and regulatory regimes have been prompted by 'deck stacking' or they simply reflect the quest for efficient decision making in a plural organization. Although much of the debate on independent regulatory agencies is comparable to that found in Germany (Doern & Wilks 1996), the EU's predilection for regulation can be explained partly by its lack of funds and the limited strength of its legal competences (McGowan & Wallace 1996). Majone (1999) argues that the development of a 'regulatory state' in the EU has been partly an effort to avoid divisive majoritarian politics, which is in line with the pluralist view that regulation exists partly to protect minorities from majority abuse of power. The member states' ceding of powers to the European Commission and European Court of Justice at successive intergovernmental conferences has been explained in classical principal-agent terms by Pollack (1997, 1999). The Court serves as a necessary and impartial referee, and the Commission monitors compliance, acts as an independent and credible regulatory and its agenda setting powers helps avoid biased and rotating agendas as the states each take six-month turns to chair the Council of Ministers. Both institutions help solve problems of incomplete contracting. Even the 'comitology' monitoring procedures whereby the states oversee and may control the

other motives for establishing independent regulators. These motives have less to do with winning the support of voters or business on the basis of efficient regulation, and more to do with maintaining support by locking in arrangements that are favorable to their supporters or by avoiding the blame when regulatory policy fails. Even if establishing agencies or organizations that operate on arm's length distance from the executive (and the legislature) may increase transparency, it does not necessarily increase political responsibility, let alone accountability (Ogus 1994, Baldwin & Cave 1999). Even if the electoral holds the government to account, and the opposition wins the election, the incoming government may find that it is not free to change the regulatory regime. The last section of the present paper duly turns to some observations on the empirical research on the causes and effects of variations in regulatory independence, and suggests that some controversies over policy may be as much the result of how independence was (deliberately) designed as of 'runaway agents' and bureaucratic drift.

5. Some observations on empirical research

The theoretical review suggests two empirical questions related to regulatory institutions. The first relates to *effects* of alternative governance structures on legislative control, the second to the factors that induce *choice* of institutional schemes.

A significant literature is emerging on both sides of the Atlantic to address the effects of independent regulatory agencies and other government non-departmental bodies. Although credibility may be an important motive for establishing independent regulatory agencies, we would not necessarily expect agencies to operate independently of legislative preferences. Cabinet, ministers and parliamentary committees oversee agency decisions, cabinet and ministers appoint boards and administrative executives, and procedural requirements (including 'fire alarms', transparency requirements and public participation) means that agencies must take some interest in shifting preferences in parliament. Political, administrative or judiciary appeals procedures may temper the actions of independent agencies. There is even a heated debate as to whether the European Court of Justice is actually the forceful independent supranational supreme court that its

the *Cassi de Dijon* case, which did much to establish the principle of ‘mutual recognition’ of goods across borders, was really such a strong blow against a member state. He suggests that the Court’s ruling might in fact have been more or less in line with the German government’s interests, given the limited importance of protecting German alcoholic beverages producers compared to the government’s commitment to free trade.

Empirical studies appear to support this expectation that actual independence may be somewhat lesser than provided for by formal rules. The US literature (which informs the debate on the ECJ) suggests that IRAs have some sensitivity to shifts in political preferences (Moe 1982; Weingast and Moran 1987; Kovacic 1987). Most of these studies have addressed decisions by the Federal Trade Commission. Other studies confirm that particular instruments – such as advisory committees – do contribute to legislative control (Balla and Wright 2001). In the context of this new research that is to a rather high extent inspired by the US institution of independent regulatory commissions it is telling to what extent it is overlooked that until recently this institution was often seen as a move of regulatory policy issues from one to another institutional arena (See for example Knott & Miller, 1987, Harris & Milkis, 1989, and the classical study by Robert E. Cushman, 1941). The literature on the European Union has long featured debates between the realist school and its various descendants, who argue that most EU policy is constrained by member state preferences, and a range of more pluralist approaches that accord the EU-level institutions more operational freedom. The European Commission’s decision to break the member state monopolies in voice telecommunications could be seen either as evidence of the institution’s independence, or as an indication that the Commission moves along trajectories that reflect the principal states’ interests.

All this does not necessarily mean that politics necessarily undermines the credibility of IRAs. Perhaps the best evidence in support for credibility is studies of central bank independence. Notwithstanding the recent challenges to the European Central Bank’s operational independence and the ensuing debacle over and revision of the Growth and Stability Pact, a large body of empirical research demonstrates that independent central banks (usually building on an index of independence proposed by Cukierman, Webb, and Neyapti) yield lower inflation than more dependent central banks. Our reading of this literature suggests that, by and large, credibility can be achieved without compromising democratic accountability.

same time the governments were reluctant to design a credible deterrent for violation of the pact (imposing fines on states in financial dire straits is hardly ideal). That controversies developed when the large states ran into conflict with the rules is hardly surprising, and hardly evidence of run-away independent authorities.

6. Conclusions

Most of the public debate on regulatory delegation has focused on the trade-off between credibility and accountability. In certain situations efficient governance calls for independent agencies, although these may undermine democratic control (at least in the majoritarian politics sense). Nevertheless, both theoretical and empirical studies suggest that creating independent agencies do not necessarily imply political abdication. A number of institutional and procedural mechanisms are used to make sure that legislative preferences leave their mark on agency decisions. Yet it would seem that what we need is a new wave of regulatory research that penetrates deeper into to

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