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The regulatory state and its legitimacy problems

Majone, Giandomenico

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Prof. Giandomenico Majone
EIPA
P.O. Box 1229
NL-6201 BE Maastricht
The Netherlands
e-mail: nbr@eipa.nl

Institut für Höhere Studien (IHS), Wien
Institute for Advanced Studies, Vienna

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Abstract

While the interventionist state was characterised by a high level of centralisation in administration and policy making, the regulatory state relies on extensive delegation of powers to independent institutions: regulatory agencies or commissions, but also the judiciary, which is becoming an increasingly active player in the regulatory game. Delegation of important policy-making powers to non-majoritarian institutions raises novel problems of democratic legitimacy. This paper argues that such problems should be tackled not by limiting the independence of the regulators, but by strengthening the accountability structure. Similar problems arise at the European level. Here, too, the correct solution is a better accountability structure rather than increased politicisation. The de-politicisation of European policy-making is a consequence of the fact that the large majority of Europe's voters support far-reaching economic integration but oppose true political integration.

Notes

Giandomenico Majone was a visiting professor at the Department of Political Science of the Institute for Advanced Studies in April 1998.

Contents

1. Introduction 1

2. The Logic of Delegation 3

3. Agency Costs 6

4. The Question of Agency Independence 8

5. Agency Independence in Europe 10

6. Accountability as a Problem of Institutional Design 13

7. Europe's "Democratic Deficit": One Problem or Two? 17

1. Introduction

Not so long ago the term “regulatory state” was considered a neologism of American origin and of dubious relevance to the European context. The scepticism was understandable since statutory regulation hardly played a role in the political economy of the Keynesian welfare state. Public ownership of key industries, especially of the public utilities, was supposed to make economic regulation superfluous; while the political significance of social regulation, such as environment and consumer protection, was minimal by comparison with traditional social policy.

That yesterday’s neologism is used more and more frequently today not only by scholars but also by policy-makers and by the media, is a clear indication of the importance which regulatory policies have achieved in recent years. The rise of regulation as a distinctive mode of policy making is due to several factors, among which privatisation and the Europeanisation of national policies are particularly significant for the present discussion[1]

The failure of public ownership, not only to keep pace with technical developments but even to provide effective consumer protection, explains the shift to an alternative mode of public control whereby the utilities and other industries deemed to affect the public interest are left in private hands but are subject to rules developed and enforced by specialised agencies. Such bodies are usually established by statute as independent administrative authorities – independent in the sense that they are allowed to operate outside the line of hierarchical control by the departments of central government. At the same time, the newly privatised companies lose their pre-existing immunity from national and European competition law. Thus the new regulatory regime includes both sectoral and general economic regulation, and in some cases (e.g. the water industry) also environmental regulation.

The Europeanisation of policy making, that is, the increasing interdependence of domestic and supranational policies within the European Community/European Union (EC/EU), has been another important factor in the growth of the regulatory state. Regulation is by far the most important type of policy making in the EC. Because the Community budget is too small to allow large-scale initiatives in the core areas of welfare-state activities – redistributive social policy and macroeconomic stabilisation – the EC executive could increase its influence only by expanding the scope of its regulatory programmes: rule making puts a good deal of power in the hands of the Brussels authorities, in spite of the tight budgetary constraints imposed by

1 For a more detailed treatment see Giandomenico Majone, “From the Positive to the Regulatory State: Causes and Consequences of Changes in the Mode of Governance”, Journal of Public Policy, 17/2 (1997), pp. 139–167.

the Member States. In other words, lacking an independent power to tax and spend, the EC had no alternative but to develop as an almost pure type of regulatory state[2]

Now, the remarkable growth of European regulations during the last decades could not fail to have a significant impact on the development of regulatory policies and institutions at the national level. For example, at the time when the Treaty of Rome was signed only Germany, among the founding members, had a modern competition law and a forceful regulatory body, the Federal Cartel Office, to implement it. Forty years later, all members of the EU have competition laws which substantially resemble European competition law, and increasingly expert and independent competition authorities that are closely linked to the Competition Directorate (DG IV) of the European Commission.

Although legal and institutional developments are not as advanced in other policy areas, the trend towards harmonisation of regulatory approaches and closer co-operation between national regulators and their EC counterparts, is clearly visible. The significant point is that the extensive delegation of regulatory powers to the European level has not reduced but actually increased the importance of regulatory policies and institutions in the Member States. This apparent paradox is easily explained. In the policy-making system created by the Treaty of Rome, implementation of most EC rules is the responsibility of the Member States, which often have to create new bodies, or at least expand existing ones, for that purpose. In addition, through the "comitology" system and in other ways, national experts play an active role in the formulation of EC rules. Hence, in order to influence the substance of European regulations and then to implement them at the national level, Member States have been forced to develop regulatory capacities on an unprecedented scale.

The transition from the interventionist to the regulatory state which is taking place in Europe today is not only understandable in light of the developments sketched above; probably it is also irreversible because of the competitive pressures of globalisation, and of the fiscal discipline imposed by monetary union. What is much less clear are the positive and normative implications of this transition. Since I have discussed the positive implications at some length elsewhere[3], this paper will be mainly concerned with the normative issues of legitimacy and accountability. These are, of course, perennial issues of democratic government, but they assume particular connotations in the context of the regulatory state. This is because one of the most striking features of this mode of governance is the extensive delegation of policy-making powers to non-majoritarian institutions – institutions which fulfil public functions but are not directly accountable to the voters or to their elected representatives.

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2 Giandomenico Majone, "The Rise of the Regulatory State on Europe", West European Politics, 17/3 (1994), pp. 77–101 and, id. Regulating Europe (London: Routledge, 1996)

3 Majone (note 1)

2. The Logic of Delegation

The willingness of legislators and political executives to delegate powers to institutions independent of the political process has been explained in various ways. Older theories emphasised cognitive factors: politicians have neither the expertise to design policies in detail nor the capacity to adapt them to changing conditions or to particular circumstances. Specialised agencies, staffed by neutral experts, can carry out policies with a level of efficiency and effectiveness that politicians, allegedly, cannot match. Note, however, that there are technical areas, such as taxation, where elected politicians show themselves to be quite capable of designing very detailed policies. Moreover, parliamentary committees and government departments routinely hire high-level consultants or rely on in-house expertise to conduct extensive policy analyses. Thus, delegation cannot be explained by cognitive factors alone.

A more sophisticated explanation is that delegation to specialised agencies reduces decision-making costs by allowing legislators and government executives to economise on the time and effort required to identify desirable refinements to legislation, and to reach agreement on these requirements. Decision-making costs increase as legislation becomes more specific because of the greater difficulty of reaching agreement when the costs and benefits of the proposed measures are spelled out in detail. Since legislators' resources are limited, spending time and effort refining legislation reduces their ability to advance other legislation or to take other actions.[4]

Delegation has also been explained by the wish to avoid blame by shifting responsibility for policy failures to other decision-makers. One of the main proponents of the blame-avoidance thesis has argued that broad delegation allows legislators to reduce the political costs of making more specific decisions: "legislators not only avoid the time and trouble of making specific decisions, they avoid or at best disguise their responsibility for the consequences of the decisions ultimately made"[5]. The same author points out, however, that the choice between narrow and broad delegation is a choice between more or less certainty of regulation or regulatory standards. Hence, everything else being equal, risk-averse legislators should prefer a narrow delegation.

Both explanations – the reduction of decision-making costs and the blame-avoidance hypothesis – have merit, but they do not tell us why, at least in Europe, delegation to non-majoritarian institutions was rather infrequent in the past and is so popular now. The reason, I

4 Mathew D. McCubbins and Thomas Page, "A Theory of Congressional Delegation", in M.D. McCubbins and T. Sullivan (eds.) Congress: Structure and Policy (Cambridge: Cambridge University Press, 1987), pp. 409–425.

5 Morris P. Fiorina, "Legislative Choice of Regulatory Forms: Legal Process or Administrative Process?", Public Choice, 39/1 (1982) pp. 33–66, at p. 47.

suggest, is that both approaches miss what is probably the main reason today for delegating policy-making powers to such institutions: the need to achieve credible policy commitments.

Of course, the issue of policy credibility is not a new one. Democracy has been defined as a form of government pro tempore[6], which means that democratic politicians operate under severe time constraints. The time limit inherent in the requirement of elections at regular intervals is a powerful constraint on the arbitrary use by the winners of the electoral contest of the powers granted to them by the voters. However, this requirement may produce negative effects when the problems faced by society require long-term solutions. Under the expectation of alternation, democratic politicians have few incentives to develop policies whose success, if at all, will come after the next election. Moreover, because a legislature or a majority coalition cannot bind a subsequent legislature or another coalition, public policies are always vulnerable to reneging and hence lack credibility.

"Short-termism" and poor credibility are intrinsic problems of democratic governance, yet they have attracted the attention of scholars and policy-makers only recently. The reasons for this lag are to be found in the growing interdependence among nations, in the increasing complexity of public policy, and, not least, in the greater role assigned to regulation. First, growing economic and political interdependence among nations has the effect of strengthening the international impact of domestic policies. Public policies are increasingly projected outside the national borders, but they cannot convince foreign governments and economic actors unless they are credible. At the national level there is a trade-off between credibility and coercion: a policy lacking credibility may be enforced, at some cost, by coercive means, but this is clearly not possible outside the national borders. Hence increased interdependence changes the nature of the trade-off by making it impossible or very costly to use coercion as a substitute for policy credibility.

Even domestically, the growing complexity of public policy reduces the effectiveness of the traditional command-and-control techniques of government bureaucracy. Until fairly recently, most of the tasks undertaken by national governments were simple enough to be organised along classical bureaucratic lines. Once a programme was enacted the details of its operations could be formulated and appropriate commands issued by highly centralised command centres. By contrast, the single most important characteristic of the newer forms of economic and social regulation is that their success depends on affecting the behaviour and the expectations of millions of individuals and thousands of organisations.[7] Hence, credibility has become a crucial resource of policy makers also at the domestic level.

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6 Juan Linz, "Democracy's Time Constraints", International Political Science Review, 19/1, (1998) pp. 19–38.

7 Charles L. Schultze, The Public Use of Public Interest (Washington, D.C.: The Brookings Institution, 1977).

Finally, the credibility of regulatory commitments is emerging as a new issue in Europe, particularly as a result of the privatisation and subsequent statutory regulation of the public utilities. These industries share a number of distinctive features. They generally exhibit important economies of scale which favour the formation of monopolies or oligopolies. For this reason, public utilities have always been subject to some form of regulation. Also, they naturally attract the attention of politicians since their customers often comprise the entire population. Again, because their assets are extremely specific or "non-redeployable", the utilities are particularly fragile industries. Once the investments have been made, politicians may be tempted to use regulation to set prices below long-run average costs, de facto expropriating the utilities' sunk costs. Hence, without a credible regulatory commitment, companies will refuse to invest, or will not invest enough to satisfy demand and to maintain the existing infrastructure.

History is full of examples of attempts to gain political advantages by manipulating the prices of utility services – and of attempts by the public utilities to fend off such actions. Thus, according to some economic historians, the initial creation of state public utility commissions in the United States was related to the inability of the municipalities to commit to stable regulatory regimes. Throughout the nineteenth century, American utilities were typically regulated at the municipal level. Between 1907 and 1922, however, nearly thirty states created utility commissions. The reason, it is argued, was to prevent cities from imposing onerous regulations that would discourage future investments.[8] The same problem of regulatory commitment is today a major issue of public utility regulation in Britain[9] and in other European countries.

In the European Union the commitment problem is compounded since national policy-makers may lack credibility not only domestically, but also in the eyes of policy-makers from other Member States. This explains why delegation of regulatory powers to the European institutions, for example in environmental policy, has gone well beyond the functional needs of the single European market. The existence of transboundary pollution problems, for instance, does not in itself require the delegation of responsibility for problem solving to the supranational level. Member States could search for common solutions through intergovernmental agreements, as they do in such important fields as justice and home affairs.

The problem with intergovernmental agreements in areas where a good deal of technical and administrative discretion is unavoidable, is that it may be difficult for the parties concerned to know whether the discretion is used properly. For example, if the agreement imposes heavy fines on industrial polluters, national regulators will be tempted not to prosecute domestic firms as rigorously if they determine the level of enforcement unilaterally rather than under

8 Werner Troesken, Why Regulate Utilities? (Ann Arbor, Mich.: The University of Michigan Press, 1996).

9 Cento Veljanovski, "The Regulation Game" in C. Veljanovski (ed.) Regulators and the Market (London: Institute of Economic Affairs, 1991), pp. 3–28.

supranational supervision. Although the monitoring capacities of EC institutions are limited, they are still superior to those provided by intergovernmental agreements. Hence the delegation of regulatory powers to the European Commission will increase the credibility of stringent regulations.

In sum, delegation to independent institutions is an important strategy for achieving policy credibility at both national and European level. As Gatsios and Seabright write: "The delegation of regulatory powers to some agency distinct from the government itself is … best understood as a means whereby government can commit themselves to regulatory strategies that would not be credible in the absence of such delegation. And it is an open question in any particular case whether the commitment is most effectively achieved by delegation to national rather than supra-national agencies"[10]

3. Agency Costs

Whatever the reasons and benefits of delegation, the transfer of policy-making powers from political principals – legislators and government executives – to bureaucratic agents also entails costs. Such "agency costs" arise because the agents do not necessarily share the objectives of their principals. They include the costs associated with selecting the agents and monitoring their performance, the costs of providing ex ante incentives and ex post sanctions, and the costs of any residual non-compliance that produces a difference between the policy enacted and what is actually implemented.[11]

From the transaction-costs perspective of the principal-agent model, delegation is justified only if its benefits exceed agency costs. The fact that delegation is so pervasive in all organizations, private and public, and at all hierarchical levels,[12] suggests that principals have various instruments at their disposal to keep agency costs within reasonable limits. In this connection it is interesting to note that before the 1980s, when political scientists started to apply agency theory to political-bureaucratic relations, most research tended to cast serious doubts on the possibility of effectively monitoring and controlling the bureaucracy. Instead, more recent theoretical and empirical studies, relying on the principal-agent model, generally show that effective oversight is possible. The main reason for these different conclusions is that agency theory has called the attention of researchers to the variety of control instruments available to political principals. Political principals create agencies, define their legal authority, objectives

10 Kristos Gatsios and Paul Seabright, "Regulation in the European Community", Oxford Review of Economic Policy, 5/2 (1989), pp. 37–60 at p. 46.

11 Murray Horn, The Political Economy of Public Administration (Cambridge: Cambridge University Press, 1995).

12 In fact, organizations have been defined as "networks of overlapping or nested principal-agent relationships", see Jean Tirole, "Hierarchies and Bureaucracies: on the Role of Coercion in Organizations", Journal of Law, Economics and Organization, 2/3 (1986), pp. 181–214, at p. 181.

and decision-making procedures, appoint key personnel, and exercise budgetary control. They also monitor agency activities to offset information imbalances, and when such activities stray from the desired result, principals have the means to bring them back into line.

In short, the key insight of agency theory is that control is to a large extent a question of good institutional design, while the older theories viewed control as being exercised from one fixed point within a given institutional framework. As will be shown later on, this more dynamic, multi-dimensional view of control is highly relevant to the legitimacy and accountability problems of non-majoritarian institutions. It should be pointed out, however, that agency theory, which has its roots in the new economics of organization, has not been used so far to deal with such normative issues. Indeed, the current popularity of the principal-agent model with political scientists may obscure some important differences between economic and political organizations. Thus, democratically accountable principals can transfer policy-making powers to non-majoritarian institutions, but they cannot transfer their own legitimacy. This loss of legitimacy can be an important, in some cases the most important, "agency cost".

The old doctrine opposing the delegation of policy-making powers to non-elected officials (delegata potestas non potest delegari) was concerned precisely with the loss of legitimacy entailed by delegation. As John Locke put it in the Second Treatise on Civil Government: "The legislature cannot transfer the power of making laws to any other hands; for it being but a delegated power from the people, they who have it cannot pass it over to others". Today, the non-delegation doctrine is generally regarded as having been effectively repealed by long-established constitutional practice. This is true even of countries, such as the United States, whose constitution was deeply influenced by contractarian political theory.[13] However, the issue is becoming again important as increasing integration of the world economy forces national parliaments to delegate important powers of rule-making and adjudication to international or supranational institutions. A concrete example is provided by the current debate about the "democratic deficit" of European institutions.

Widespread concern about an alleged deficit of democracy at the European level is a fairly recent phenomenon. According to the view prevailing before the Single European Act and the Treaty on European Union (TEU), the integration process derives its legitimation from the democratic character of the Member States. National parliaments ratify the treaties; democratically accountable heads of state or government, meeting in the European Council, set strategic priorities; the Council of Ministers, composed of people who are normally elected politicians, must approve Commission's proposals before they become European law. Thus the entire process is guided and controlled by sovereign democratic states.

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13 James Freedman, Crisis and Legitimacy (Cambridge: Cambridge University Press, 1978).

This argument was still being used in 1993 by the German Constitutional Court. In the Brunner case, the Court derived the constitutionality and legitimacy of the TEU from the democratic legitimacy of the countries which signed it. It argued that the TEU, like the previous European treaties, is nothing more than an international agreement among sovereign states. The members oft he Union, the Court said, remain the "lords of the Treaties" and never surrendered their power to secede.

To evaluate the validity of such arguments it is important to recall that the institutional architecture of the European Union includes two distinct elements: an intergovernmental component, where international features dominate (European Council, Council of Ministers, and the second and third "pillars" of the TEU); and a communitarian component (European Parliament and Courts, Commission, and the policies and activities included in the first "pillar" of the TEU). Now, the democratic character of the Member States (the political principals) may be sufficient to legitimate the intergovernmental component of the Union, but such indirect legitimation cannot provide an adequate normative foundation for its supranational component. This is because one of the most important tasks of the supranational institutions is to protect the rights and interests (as defined by the Treaties) of the citizens of the Union, even against the majoritarian decisions of a Member State or against the preferences of a majority of the Member States. Hence, the supranational institutions of the EC cannot be legitimated by proxy, but must establish their own autonomous legitimacy, either through electoral channels (the case of the European Parliaments), or by other procedural and substantive means to be discussed in the second part of this paper.

4. The Question of Agency Independence

As noted above, one of the most characteristic features of the regulatory state is the extensive delegation of policy-making powers to agencies operating at arm's length from government. Independent agencies are a response to the credibility problems of democratic politicians: they can provide greater policy continuity and consistency than cabinets precisely because they are one step removed from electoral returns. Agencies fulfil several other important functions. They combine expertise with a rule-making or adjudicative function, a combination that is deemed inappropriate to a government department; an agency structure may favour public participation, while the opportunity for consultations by means of public hearings is often denied to government departments; the exercise of a policy-making function by an expert agency can provide flexibility not only in policy formulation but also in the application of policy to particular circumstances; not least, specialised agencies are able to focus public attention on controversial issues thus enriching public debate.[14] For all these functions, a certain amount of

14 Robert Baldwin and Christopher McCrudden, Regulation and Public Law (London: Weidenfeld and Nicholson, 1987).

independence from direct political or bureaucratic controls is useful, even necessary. However, it is important not to overstate in theory the degree of independence that exists in practice.

For example, according to the US Administrative Procedure Act (APA) of 1946, an agency is a part of government that is generally independent in the exercise of its functions and that by law has authority to take final and binding action affecting the rights and obligations of individuals, particularly by the characteristic procedure of rule-making and adjudication. However, agency status does not require than an agency exercise its power with complete independence, either vertically (in terms of being subject to administrative review) or horizontally (in terms of being required to act in concert with others). If an authority is in complete charge of a programme, it is an agency with respect to that programme, despite its subordinate position in other respects.[15]

In light of such careful language, it is surprising to find that an important body of public opinion still views agency independence as a threat to democratic values. According to a well-known critic of the American independent regulatory commissions (IRCs), the independence of these bodies "represents a serious danger to the growth of political democracy in the United States. The dogma of independence encourages support of the naive notion of escape from politics and the substitution of the voice of the expert for the voice of the people".[16]

In reality, the independence of American regulators, far from being a dogma, has always been constrained and controlled in various ways. Even the IRCs are independent only in the sense that they operate outside the presidential hierarchy and that – as asserted by the Supreme Court in Humphrey's Executor vs. United States (1935) – commissioners cannot be removed from office for disagreement with presidential policy. All regulatory agencies are created by congressionally enacted statutes and regulators are appointed by elected officials. The programmes they operate are defined and limited by such statutes; their limited authority, their objectives and sometimes even the means to achieve those objectives are specified in the enabling laws.

Furthermore, regulatory discretion is constrained by procedural requirements that have become increasingly stringent over time. Under the APA, agency adjudication was made to look like court adjudication, including the adversarial process for obtaining evidence through presentations of the contending parties, and the requirement of a written record as the basis of agency decision. APA requirements for rule-making were considerably less demanding, but this

15 Freedman (note 13).

16 Marver Bernstein, Regulating Business by Independent Commissions (Princeton, N.J.: Princeton University Press, 1955).

difference did not matter much as long as most regulation was of the rate-setting and permit-allocation types and hence relied largely on adjudication.[17]

With the growth of environmental and risk regulation in the 1960s and 1970s, however, rule-making became much more important. Hence, federal judges began to develop stricter standards of judicial review for standard setting and other rule-making proceedings. Starting from the general requirements contained in the APA, they succeeded in formulating new principles to improve the transparency and substantive rationality of rule-making. As a consequence of these judge-made procedural requirements, today rule-making has to be accompanied by records and findings even more elaborate than had been originally envisaged for formal adjudication.

In sum, although the independent administrative agencies are non-majoritarian in the precise meaning that they are not directly accountable to the people through electoral and political processes, they are hardly free form procedural and substantive constraints imposing a form of accountability. Public accountability is provided by the requirements that the agencies promulgate rules to guide their discretion and give reasons for their decisions, by the extensive regime of legislative supervision and executive influence, by the opportunities for public participation that administrative hearings afford, and by the pervasive discipline of judicial review to ensure that agency actions are consistent with the instructions of a democratically elected legislature. Thus, independence from direct political control does not mean independence from public accountability.[18]

5. Agency Independence in Europe

While the meaning of the political independence of regulators is reasonably clear in America, this is not yet the case in Europe. European governments are by now quite aware of the importance of policy credibility in an increasingly interdependent world, and thus are prepared to accept the independence of national and European regulators in principle; in practice, however, they are often driven by considerations of political expediency, as well as by habits acquired in the days of pervasive state interventionism, to interfere with the regulators' decisions. As a result, European agencies have less independence, de facto and generally also de jure, than American agencies. At the same time, they are subject to a less stringent regime of public accountability.

Thus the way in which the French Autorités Administratives Indépendantes have been designed and their powers defined leaves a considerable margin of influence to the Government. The

17 Martin Shapiro, Who Guards the Guardians? (Athens, GA.: University of Georgia Press, 1988).
18 Freedman, Crisis and Legitimacy (note 13), pp. 72–73.

competition authority (Conseil de la Concurrence), for example, cannot initiate investigations – this crucial power remains in the hands of government. Actually, the 1986 competition law strengthens the power of the Minister of Economics in relation to mergers, and generally preserves a considerable margin of arbitration and discretion to the central government.[19]

Similarly, under the Spanish competition law of 1989, the government, not the regulator – the Competition Tribunal (Tribunal de Defensa de la Competencia) – has been delegated the main responsibility for controlling mergers. The Minister of Economics and Finance does not have to inform the Tribunal about mergers which the Minister approves. Also the important power to exempt particular industries or activities from the application of competition rules is reserved to the government.[20]

The German Cartel Office (Bundeskartellamt) has more extensive powers than the competition authorities of France or Spain, and indeed of any other European country. Yet, even in Germany the government retains considerable powers of intervention in competition policy and especially in merger cases. The case of the Daimler-Benz-MBB merger, in which the Minister of Economics overruled the negative decision of the Cartel Office and disregarded the President of the Monopoly Commission, is instructive in this respect despite its rather exceptional nature.

In Britain many of the most significant powers in the area of public utility regulation are often given directly to the government rather than to the new Regulatory Offices (ROs). The operation of the ROs is still largely dependent on prior decisions of the responsible minister as to the principles to be applied. The danger is that such powers of direction "could be abused to exert behind-the-scenes pressure on the regulator in much the same way as pressure was put on the nationalized industries by government".[21] Agency independence is even more problematic in the case of environmental and risk regulation. A well-known expert of British regulation of workplace health and safety, Robert Baldwin, has written about the risk of "devastating ministerial interference" in this area, while Albert Weale has argued that despite the formal separation of the water pollution regulator – the National Rivers Authority (NRA) – for the Department of the Environment, there can still be political pressures placed on the NRA not to pursue particular cases with vigour. In fact, the first Director General of the NRA resigned

19 Fabrice Demarigny, "Independent administrative authorities in France and the case of the French Council for Competition", in Majone, Regulating Europe (note 2), pp. 157–179.

20 Lluis Cases, "Competition law and policy in Spain: implementation in an interventionist tradition", in Majone, Regulating Europe (note 2), pp. 180–201.

21 Tony Prosser, "Regulation of privatized enterprises: institutions and procedures", in L. Hancher and J. Moran (eds.) Capitalism, Culture and Economic Regulation (Oxford: Clarendon Press, 1989), pp. 125–165, at p. 147.

allegedly because of pressures from a minister in the Department not to impose a stringent discharge consent on a textile firm near the minister's own constituency.[22]

The limits of the political independence of regulators remain uncertain also at the EC level. This is even more worrying since the credibility and coherence of European regulatory law depends crucially on the perception that the Commission is able and willing to enforce the common rules in an objective and even-handed way. For this reason, Article 157 of the Treaty of Rome mandates that the members of the Commission shall be completely independent in the performance of their duty. In practice, however, the Commissioners are not immune from influences both from the Member States and from within the Commission itself. Although they are not supposed to pursue national interests, many European Commissioners are politicians who, after leaving Brussels, will return to their home country to continue their career there. This makes national pressures often difficult to withstand. On the other hand, the Commission is a collegial body, and the need to achieve a majority within the collegium has on several occasions produced flawed or inconsistent regulatory decisions. In addition, the growing role of the European Parliament as Community co-legislator is bound to increase the politicisation of the EC policy-making process.

Coming back to the national level, I have suggested above that a relatively low level of agency independence is generally accompanied by a poorly specified accountability structure. This can be seen most clearly in the case of Britain which, having pioneered the privatisation of public utilities, has the most extensive system of economic regulation in Europe. Although British regulators are technically accountable to Parliament, there is very little structure supervision; and despite a significant growth in the scope of judicial review in recent years, the impact of the courts on the quality of decision-making by regulatory agencies is weak and offers no real protection to interests affected by regulation. In practice, as Veljanovski writes, "English administrative law acts as a positive inducement for regulatory agencies not to state clear criteria nor to give reasons for their decision, thus preventing the courts from reviewing their actions"[23]. The same author notes that despite much lip-service being paid to the idea of transparency in regulation, the regulators have shown that they are prepared to keep crucial facts away from public scrutiny, particularly on key matters such as whether the prices charged by the public utilities bear a reasonable relationship to cost. More generally, the new regulatory agencies have failed to provide a clear framework for their decision-making. It will be recalled that to provide such a framework was one of the main objectives of the US Administrative Procedure Act. Similar procedural requirements would greatly increase the legitimacy of regulatory institutions in Europe, both at national and EC levels.

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22 Robert Baldwin, "Regulatory legitimacy in the European context: the British Health and Safety Executive", in Majone, Regulating Europe (note 2), pp. 83–105; Albert Weale, "Environmental regulation and administrative reform in Britain", in Majone, Regulating Europe (note 2), pp. 106–130.

23 Veljanovski (note 9), p. 17.

6. Accountability as a Problem of Institutional Design

Whether political independence and democratic accountability can in fact be reconciled depends crucially on the way in which the relationships between electorally accountable principals, non-majoritarian institutions, and the general public are structured. As was already noted, political principals create independent agencies, define their legal authority, objectives and decision-making procedures, appoint key personnel, and exercise budgetary control. They can also monitor agency activities to offset information imbalances, and when such activities stray from the desired result, principals have the means to bring them back into line. Such powers can and should be used not only to provide ex ante legitimacy, but also to design institutional arrangements capable of ensuring transparency and public accountability over time. In short, it is up to the political principals to structure relationships with their agents so that the outcomes produced through the agents' efforts are compatible with basic requirements of democratic accountability, given the choice to delegate in the first place. Agency theory suggests that the following variables are crucial for the design of an effective accountability structure[24].

1. The extent to which decisions are delegated to an independent agent rather than taken by the principal himself, with the choice ranging from "no delegation" to "full delegation".

2. The governance structure, which includes both organisational form – single-headed agency, multi-headed commission, self-regulatory organisation, and so on – and methods of appointment of key personnel. The nature of the governance structure to a large extent determines the degree of independence of the agency from the political process.

3. The rules that specify the procedures to be followed in agency decision-making. Examples are reason-giving requirements (see below), and rules defining the rights of various groups to participate directly in the decision-making process.

4. The procedures to be followed when principals wish to overrule agency decisions.

5. The allocation of resources, in particular the agents' employment conditions, and the extent to which the agency is to be financed by government or by the sale of its services.

6. The extent of ex post monitoring through ongoing legislative and executive oversight, the budgetary process, judicial review, citizens' complaints, and peer review.

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24 Horn (note 11).

A judicious selection of the value to be assigned to each of these variables – more or less delegation, greater or lesser independence, more or less stringent procedural requirements, and so on – in light of the nature of the delegated tasks and of the relevant political and institutional setting, will go a long way toward ensuring that independence and accountability are indeed complementary and mutually supporting, rather than antithetical, values. A full discussion of the principles of institutional design, or even of the design variables listed above, would require a separate treatment. Here I will only add a few comments on procedural requirements, starting with reason-giving.

The simplest and most effective way of improving transparency and accountability is to require that regulators give reasons for their decisions. This requirement activates a number of other mechanisms for controlling regulatory discretion and enhancing regulatory legitimacy, such as public participation and debate, peer review, complaint procedures, and judicial review. In the words of Martin Shapiro, "giving reasons is a device for enhancing democratic influences on administration by making government more transparent. The reasons-giving administrator is likely to make more reasonable decisions than he or she otherwise might and is more subject to general public surveillance".[25]

For example, the requirements imposed by American courts to improve the procedural and substantive rationality of agency decision-making have been achieved largely by elaborating the reason-giving requirements of the Administrative Procedure Act. As we shall see, also the framers of the treaties establishing the European Communities were well aware of the special importance of giving reasons for institutions not directly accountable to the voters or to their elected representatives.

Thus, the reason-giving requirement is a necessary condition for public accountability. Similarly, clear procedures for overriding agency decisions are necessary for transparency and for a correct allocation of political responsibility. In a democracy it is impossible to exclude the possibility that political principals may override the decisions of their agents when they feel that those decisions are not in the public interest. An important characteristic of independent agencies is the limited scope of their competences. A strict commitment to specific policy objectives is necessary in order to enforce accountability by results, which is one of the main sources of legitimation for non-majoritarian institutions. However, the consequences of particular regulatory decisions cannot always be contained within the narrow policy area assigned to the agency: some environmental measures may have serious consequences for employment, just as the decision of the competition authority in a merger case could have important implications for industrial policy. When such spillovers are significant, value conflicts ensue which only electorally accountable policy-makers should resolve. The important point,

25 Martin Shapiro, "The giving-reasons requirement". (Chicago, Ill.: The University of Chicago Legal Forum, 1992), pp. 180–220, at p. 183.

however, is that the political decision to disregard the conclusions of the agency must be taken in a transparent way, following well-defined and generally known procedures. Also, overriding agency decisions should be neither too easy nor too difficult. If interference with agency decisions entails only negligible costs, the agency is not independent, and delegating powers to it cannot increase policy credibility; but if political intervention is too difficult there may be a serious loss of legitimacy. These various possibilities will be briefly illustrated by means of examples.

In a preceding section of the paper we have noted the tendency of European governments to interfere with the decisions of the national competition authorities, especially in merger cases. This is true also of Germany, but with an important difference. The procedures which the government must follow when it wishes to overrule a decision of the Cartel Office entail high political costs and make the interference plain for all to see. Thus, if the Cartel Office refuses to authorise a merger on the grounds that the merger is likely to lead to the creation or strengthening of a dominant position, firms may apply to the Minister of Economics for an authorization. The Minister will evaluate both the advantages and disadvantages of the merger. This evaluation is based on the judgement of the Cartel Office, set against the advantages for the entire economy. In addition, the Minister must obtain the opinion of another independent body, the Monopoly Commission. Because of these strict procedural requirements, the Minister overrides the decisions of the Cartel Office only on rare occasions.[26]

Another German non-majoritarian institution, the Bundesbank, has enjoyed a high level of political independence since its creation in 1957. This independence has not prevented a good deal of informal consultation and coordination with governmental policy-makers, as well as open clashes with christian-democratic (Adenauer) and social-democratic (Helmut Schmidt) chancellors. In 1990, immediate monetary union with East Germany was imposed by Helmut Kohl against the vocal opposition of the then president of the Bundesbank, Karl-Otto Pöhl. The Bank responded with a policy of high interest rates which created serious problems not only for the German but for all other European governments.

Thus the independence of the Bundesbank is far from being absolute. The basic reason why the Bank does not operate in a political vacuum is that the foundation of its independence is the Bundesbank Law of 1957, and a law can always be changed by a parliamentary majority. Even a central bank as independent as the Bundesbank in the long run has to follow a policy which is broadly in agreement with the wishes of democratically elected politicians. The case of the European Central Bank (ECB) is different.

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26 Pio Baake and Oliver Perschau, “The law and policy of competition in Germany”, in Majone, Regulating Europe (note 2), pp. 131–156.

The Maastricht Treaty gives the ECB, which is not a Community institution within the meaning of Article 4 of the Rome Treaty, the power to make regulations that become European and Member States' law without the involvement of national parliaments, the European Parliament or other Community institutions. Since the independence of the ECB is guaranteed by the Treaty, it has an even stronger legal basis than the Bundesbank's independence. With minor exceptions, the status of the ECB can only be modified through Treaty amendment, which requires the unanimous consent of the Member States. Thus electorally accountable politicians can override ECB's policies only through an extremely demanding procedure. At the same time, the only formal accountability requirement for the ECB is to present an annual report on the activities of the European System of Central Banks and on the monetary policy of the previous and the current year to the European Council, the European Parliament, the Council and the Commission. As an extra guarantee of independence, the ECB has financial autonomy in that its income and expenditures do not fall under the Community budget.

There is some justification for this exceptional level of independence. On the one hand, the ECB has to establish its reputation as an inflation fighter within a short time. In an effort to convince the markets, and a sceptical public opinion, that the Euro will be as strong as the Deutsche Mark it seemed advisable not just to emulate the Bundesbank model, but to push that model to its extreme limit. On the other hand, the ECB has no obvious political counterpart at the European level. Fiscal policy is still under the control of the national governments – at least as long as the public deficit remains within the Maastricht parameters – while national preferences about desirable levels of inflation are too different to imagine that the Council of Ministers could set precise policy targets for the Bank to achieve, or even indicate a coherent macroeconomic strategy.

In spite of such problems, it would have been possible to design a more satisfactory accountability structure. The "democratic deficit" of the ECB is already becoming a serious issue, adding new fuel to the debate about the normative foundations of European integration. This is an important but often confused debate. In the concluding section of the paper I attempt to introduce some clarification, with the help of the conceptual apparatus developed in the preceding pages.

7. Europe's "Democratic Deficit": One Problem or Two?[27]

It is analytically convenient to classify arguments about the democratic deficit into four groups according to the standards of legitimacy on which they rely, if only implicitly. Arguments in the first group use standards based on the analogy with national institutions. Such arguments equate Community institutions with the familiar institutions of parliamentary democracy, or at least assume that EC institutions will converge towards this model. The analogy with national institutions leads, for example, to the claim that the European Parliament (EP) should have an independent power of legislative initiative because national parliaments are so empowered.

The second group of arguments do not rely on the analogy with actual democratic institutions in the Member States, but on an abstract model of democracy — the pure majoritarian or "Westminster" model. According to this model, parliament is the ultimate source of legitimacy in a representative democracy. The European Parliament is the only (or at least the principal) repository of democratic legitimacy in the Community. Hence increased powers to the EP would substantially reduce the democratic deficit and restore legitimacy to the process of European integration.

Another group of arguments are ostensibly about the democratic deficit, but in fact are driven by a different agenda: dissatisfaction with the slow pace of political integration, or concerns about the future of the national welfare state in an integrating European and world economy. The EC, it is suggested, lacks legitimacy not only because it lacks a true legislative body and electorally accountable policy-makers, but especially because of its failure to provide social justice. By the standards prevailing in most Member States, the ECB is a "welfare laggard" and thus cannot count on the popular acceptance enjoyed by the national welfare states.

According to the last group of arguments, the legitimacy of European integration and of Community institutions proceeds from the democratic legitimacy of the Member States. The veto power of each Member State is the single most legitimating element of the integration process. Hence the shift to majority voting since the Single European Act is an important cause of the legitimacy problem: it weakens national parliamentary control of the Council without increasing the powers of the EP.[28] Such derived standards of legitimacy have already been discussed in the section of the paper dealing with agency costs. There it was pointed out that the democratic character of the Member States may be sufficient to legitimate the intergovernmental component of the EU. The supranational institutions, however, must be able

27 This section relies heavily on my paper "Europe's 'Democratic Deficit': The Question of Standards", European Law Journal, forthcoming.

28 Joseph H.H. Weiler, "The Transformation of Europe", Yale Law Journal, 100/3 (1991), pp. 2403–2437.

to achieve their own autonomous legitimacy since their task is to protect Community values even against the majoritarian decisions of the Member States.

I shall now briefly consider the other arguments. The most obvious objection to the analogy with national institutions is that the sui generis institutional architecture of the Community has been designed by treaties duly ratified by all national parliaments. One of the characteristic features of the EC is the impossibility of mapping functions onto specific institutions. For example, the EC has no legislature but a legislative process in which different institutions — Commission, Council and EP — have different parts to play. Such institutional arrangements are certainly unusual by the standards of the classical separation-of-powers doctrine, but they do serve important functions. Thus, if the Treaties make the decision-making powers of the Council and of the EP dependent on the proposals of the Commission, this is not to give a privileged position to a supranational bureaucracy against the democratically legitimated representatives of the Member States or the popularly elected members of the European Parliament. Rather, the Commission's monopoly of legislative proposals is a mechanism for linking more closely the Council and the EP to European law and its supranational objectives.

Another striking difference between the national and the European levels is the fact that the Community is a system of limited competences. At least since the Maastricht Treaty of European Union (TEU), the continuous accretion of powers to the Community is no longer on the political agenda. In fact, the new precise delimitation of Community powers was a major result of the TEU. Article 3b of the Treaty, which enacts the principles of attribution of powers, of subsidiarity, and of proportionality as organising principles of the constitutional order of the EC, marks a shift in the Community's deep structure. In the words of professor Dashwood, the article effectively rules out of court the notion of a Community continuously moving the boundary posts of its own competence.[29]

The TEU also throws new light on the limits of previous grants of powers, especially the creation of subsidiary powers by means of Article 235 of the Rome Treaty, which enables the Council to take appropriate measures in case where action by the Community is found to be necessary to attain one of the objectives of the Treaty and there is no specific power available for that purpose. In the past, the Council has made liberal use of Article 235 to expand Community competences or to broaden the reach of EC legislation in such areas as economic and monetary union, social and regional policy, energy and environment, and co-operation agreements with third countries. Post-Maastricht, however, Article 235 makes sense only if the reference to the attainment of a Community objective "in the course of the operation of the common market" begins to be taken seriously. This means that subsidiary powers would be created under this article only for matters directly connected with the policies that lie at the

29 Alan Dashwood, "The Limits of European Community Powers", European Law Review, 21/1 (1996), pp. 113–128.

very core of the EC but not, for example, for programmes of technical assistance such as PHARE and TACIS, however worthy their objectives.[30]

The limits on the powers of the EC are not only legal, but also financial. The EC has no general taxing and spending powers similar to those held by national governments. With a budget of less than 1.3 per cent of Union GDP and which, moreover, must always be balanced, the Community can only undertake a limited range of (mostly regulatory) policies.[31] Such limitations are particularly important from the perspective of this paper because questions of legitimacy are really questions about the use of power. Hence standards of legitimacy and accountability historically developed to control an omnicompetent state with virtually unlimited powers to tax and spend, cannot be directly applied to a system of limited competences and resources such as the EC.

Concerning the second group of arguments, it suffices to point out that any federal or quasi-federal system is incompatible with the pure majoritarian model of democracy since the component units owe their autonomous existence to institutional arrangements - vertical and horizontal separation of powers, checks and balances, over-representation of small jurisdiction, judicial review - that prevent the domination of minorities by majorities. Non-majoritarian institutions are important not only in federal-type systems, but in all "plural" societies, i.e., "societies that are sharply divided along religious, ideological, linguistic, cultural, ethnic or racial lines into virtually separate sub-societies with their own political parties, interest groups, and media of communication".[32] Careful empirical studies have shown that there is a strong correlation between the needs of cleavage management in plural societies and the number and importance of non-majoritarian features in their political systems.

The EU is divided by a number of deep cleavages: linguistic, geographical, economic, ideological and, especially, the division between large and small Member States. It is not surprising, therefore, that the European institutional architecture includes so many non-majoritarian features. Such features are best understood as mechanisms of cleavage management. However imperfect, such mechanisms have been essential to the progress of European integration, while a consistent application of majoritarian standards would only produce deadlock and possibly even disintegration.

Finally, we come to the third group of critics of Europe's democratic deficit. These critics are less concerned with the weak position of the European and national parliaments in the integration process, or with the loss of control by the Member States, than with the future of social entitlements in the integrated European market. They fear that competition between different national welfare regimes could lead to regime shopping, social dumping and far-

30 Dashwood (note 29).
31 Majone (note 2)
32 Arend Lijphart, Democracies (New Haven, CT: Yale University Press, 1984), p.22.

reaching deregulation of labour markets. A full-fledged European social policy would not only prevent such negative developments; it would also increase the legitimacy of the EC just as, in the past, social policies proved to be an essential source of democratic legitimation for the nation-state. A comprehensive European social policy, it is argued, could do the same for European integration. Unfortunately, it is more likely that the result would be exactly the opposite.

First, the very modest role of social policy in the process of European integration is due to the reluctance of the Member States to surrender control of such a politically sensitive area of public policy, and to transfer the necessary competences and resources to the Community. This reluctance is clearly expressed in the Treaty of Rome. The enumeration of matters relating to the social field in Article 118, and the limited role given to the Commission in this area indicate quite clearly that social policy, with a few exceptions such as the social security regime for migrant workers, was originally considered to be beyond the competence of the Community. Neither the Single Act nor the Maastricht and Amsterdam Treaties have provided true legislative competences in the social field. On the contrary, harmonisation of the social legislations of the Member States has been explicitly excluded.

Integration of health and social security is opposed also by a majority of citizens. Eurobarometer data show that this opposition is long-standing, and that since 1989 support for social-policy integration has actually declined among the wealthier Member States. This reluctance to involve the Community in policies dealing with personal distribution of income is understandable. On the one hand, each welfare state represents a unique combination of national traditions and the political compromises that formed the basis of social consensus in the various West European countries after the war – a combination which cannot be replicated at the European level. On the other hand, the delicate value judgements about the appropriate balance of efficiency and equity which social policy expresses, can be made legitimately only within homogeneous polities – as shown by the fact that in several countries even national redistribution in favour of poorer regions is increasingly challenged in the name of fiscal federalism and regional autonomy. It is difficult to see how politically acceptable levels of income redistribution could be determined centrally in a system like the EC, where economic, social, political and legal conditions are still so different. In sum, the attempt to legitimate the Community through social policy would actually aggravate the problem – reinforcing the popular image of a highly centralised and bureaucratised system – because it would go against the clearly expressed preferences of the governments and the citizens of the Member States.

Our brief survey shows that opinions differ widely as to the causes, consequences and possible remedies of the legitimacy problem at European level. In spite of these differences, all schools of thought seem to share a common perception of the democratic deficit as something peculiar to the EC/EU. In a sense this is true. If the expression is taken literally – an absence or incomplete development of institutions which we take for granted in a parliamentary

democracy – then a deficit of democracy is indeed a distinctive feature of a process in which economic and political integration not only move at different speeds but also follow different principles – supranationalism in one case, inter-governmentalism in the other. We cannot expect parliamentary democracy to flourish at European level as long as European voters support far-reaching economic integration but continue to see in the nation-state the principal focus of their loyalty and the real arena of democratic politics. The separation of economic and political integration entails the de-politicisation of European policy-making. This de-politicisation is the price we pay in order to preserve the political dimension of national sovereignty largely intact. These being the preferences of the national electorates, we can only conclude that the democratic deficit, in the literal sense, is democratically justified.

There is, however, another sense in which the expression is used. In its broader meaning "democratic deficit" refers to such defects of public decision-making as lack of transparency, insufficient public participation, unwillingness to give reasons, abuse of technical or administrative discretion, inadequate mechanisms of control and accountability. The arguments presented in the preceding sections show that such problems, far from being unique to the European level, are becoming increasingly important at all levels of government as more and more powers are delegated to non-majoritarian institutions. By design, such institutions are not directly accountable to the voters or to their elected representatives. Their legitimacy is, at best, indirect, and is subject to a number of procedural and substantive criteria.

By such criteria, Community institutions compare favourably with non-majoritarian institutions at the national level. Thus, as already mentioned, the founding treaties require Community institutions to state the reasons on which their decisions are based. At the time the treaties were enacted there was no general requirement to give reasons in the law of the Member States, so that these Community provisions were not only different from, but in advance of, national laws. Moreover, the European Court of Justice is quite prepared to impose the obligation of giving reasons upon the national authorities in order that individuals be able to protect their rights in so far as they arise under Community law. In the Heylens case the Court reasoned that effective protection requires that the individual be able to defend his or her right under the best possible conditions. This would involve judicial review of the national authority's decision restricting that right. For judicial review to be effective, however, the national court must be able to call upon the authority to provide its reasons.[33]

Of course, much remains to be done to improve procedural and substantive legitimacy, also at the European level. The enactment of an Administrative Procedure Act for the EC would provide the Community with a unique opportunity to decide what kind of rules are more likely to rationalise decision-making, to what extent and in which form interest groups should be given

33 Robert Thomas, "Reason-giving in English and European Community Administrative Law", European Public Law, 3/2 (1997), pp. 213–222.

access to the regulatory process and the possibility of dialogue with the Commission, or how substantive judicial review could be facilitated. The proliferation of committees, working groups, and agencies, shows how urgent is the need for a single set of rules explaining the procedures to be followed in regulatory decision-making. The growth in the number of such bodies, the overlap of their activities, and the divergences between the rules governing their functioning create a real lack of transparency.[34]

However, the need for greater transparency and accountability in regulatory decision-making is even more urgent in the Member States. If regulatory legitimacy seems to be a more acute problem at the European level this is because the regulatory function, relative to the more traditional socio-economic functions of government, is much more important here than at the national level. Hence the European regulatory state provides an ideal context in which to develop and test new methods for legitimating non-majoritarian institutions, before such methods are adopted at national level. A good example is the gradual extension of the reason-giving requirement from European to national administrative law. A European Administrative Procedure Act would be an even more important contribution to the legitimacy of regulatory policy-making.

In the final analysis, the legitimacy of non-majoritarian institutions depends on their capacity to engender and maintain the belief that they are the most important ones for the functions entrusted to them. In post-Maastricht Europe this capacity can be fully developed only if national and EC regulators will exercise their functions as members of trans-national networks held together by shared objectives and regulatory philosophies, just as, within the sphere of Community law, national and European courts increasingly see themselves as parts of the same legal order.

34 Renaud Dehousse, Christian Joerges, Giandomenico Majone and Francis Snyder, “Europe After 1992: New Regulatory Strategies” (Florence: European University Institute, EUI Working Paper Law 92/31, 1992), p. 30.