

# The Agency Model: The Growth of Regulation and Regulatory Institutions in the European Union\*<sup>1</sup>

*Giandomenico Majone*<sup>2</sup>

*Visiting Professor, EIPA*

## **Agencies and the new mode of governance**

While agencies are certainly not a new feature of public administration in Europe, their importance has grown so much in recent years that they can no longer be treated as marginal additions to more traditional administrative structures. Rather, they should be seen as key elements of a new mode of governance that relies less on the power of taxing and spending – the very foundation of the Keynesian welfare state – and more on the power of making and enforcing rules. Typically, rules are made and enforced by expert agencies operating at arm's length from government. Thus, the growing significance of the agency model is perhaps the clearest indication of the transition from the interventionist state of the past to the regulatory state of the future. So important are the implications of this transition that this paper deals primarily with regulatory institutions rather than with operational agencies such as the British 'Next Step' or the Swedish line agencies. It can be shown, however, that the growth of operational agencies and 'third party' government also raises serious regulatory issues.

The new model of governance that began to emerge in Europe in the late 1970s includes privatisation, liberalisation (i.e., more competition in the market and the public sector), welfare reform, and deregulation. Indeed, deregulation is generally considered to be one of the distinctive features of the new model. Paradoxically, the same period has seen an impressive growth of regulatory policy-making both at national and European level. The paradox, however, is more apparent than real. What has happened, in fact, is that traditional methods of regulation and control which were breaking down under the pressure of powerful technological, economic, and ideological forces have been dismantled or radically transformed. This is often referred to as 'deregulation', but the term is misleading. There has been no dismantling of all public regulation, no return to a laissez-faire situation which actually never existed in Europe, but rather a combination of deregulation and re-regulation has been effected at a different level of governance (e.g. European rather than national) or by different means.

Thus, privatisation of the public utilities is typically followed by regulation of prices and conditions of service, while the newly privatised firms lose their previous immunity from national and European competition law. Deregulation can also mean less restrictive and rigid regulation. For example, the

rationale for some form of government intervention has seldom been challenged in the increasingly important area of social regulation – environment, health, safety, consumer protection. The issue here is not, strictly speaking, deregulation but rather how to achieve certain regulatory objectives by less burdensome methods. Thus, the replacement of environmental standards by pollution taxes does not do away with environmental regulation but only introduces different, and presumably more effective, policy instruments.

## **The growth of the regulatory state**

The increasing importance of regulation, relative to other policy types, is due to several causes, two of which are especially important in the present context: privatisation and the Europeanisation of policy-making.

To understand the relationship between privatisation and regulation (more precisely: statutory regulation administered by specialised agencies or commissions), one must keep in mind that, historically, public ownership has been the main mode of economic regulation in Europe. State or municipal ownership became widespread toward the end of last century with the development of public utilities – gas, electricity, water, public transportation, the telegraph and, later, the telephone. These industries, or some of their parts, are natural monopolies which all produce necessities and were often considered to be strategically important. Hence, it was assumed that public ownership would give the state the power to impose a planned structure on key sectors of the economy and at the same time protect the public interest against powerful private interests.

Experience was to show that public ownership and public control cannot be assumed to be identical. The problem of imposing effective public control over the great nationalised enterprises proved so intractable that the main objective for which they had ostensibly been created – regulating strategic sectors of the economy in the public interest – was almost forgotten.

The failure of regulation by public ownership explains the shift to an alternative mode of control whereby public utilities are left in private hands but are subject to rules developed and enforced by agencies such as the Regulatory Offices in Britain. Such bodies are established by statute (hence the term 'statutory regulation') as independent administrative authorities – independent in the sense that they are allowed to operate outside the line of hierarchical control by the

\* Un bref résumé de cet article en français figure à la fin.

departments of central government.

The causal link between privatisation and statutory regulation provides an important, but partial, explanation of the growth of the regulatory state in Europe. An even more important factor is the Europeanisation of policy-making, by which is meant the increasing interdependence of domestic and supranational policies within the European Community/European Union (EC/EU). Despite the recent slowdown in the legislative activity of the Community, the last decades have witnessed an impressive growth of EC regulation. For example, the French *Conseil d'Etat* has calculated that by 1991 the EC was introducing more rules into the corpus of French law than the national authorities themselves, while only 20 to 25 per cent of all legal norms applicable in France are issued by the national government without any prior consultation in Brussels. Presumably, an analogous situation prevails in all other Member States. Thus, EC environmental regulation today includes more than 200 pieces of legislation, so that in many countries the corpus of environmental law of EC origin outweighs that of purely domestic origin.

Such a growth of European regulations could not fail to have a significant impact on the development of regulatory policies and institutions at national level. Competition policy provides a clear illustration of this impact. When the Treaty of Rome was signed, only Germany, among the founding members, had a modern anti-trust law and a forceful regulatory agency, the Federal Cartel Office, to implement it. Forty years later, all Member States have competition authorities that are becoming increasingly powerful and jealous of their independence.

As this example shows, the delegation of regulatory powers to the European level has not reduced, but actually increased, the importance of regulatory policies and institutions at national level. This is because, under 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 short, in order to take an active part in the formulation of all these new rules in Brussels and then implement them at national level, Member States have been forced to develop regulatory capacities on an unprecedented scale. In this way, the development of the EC as a 'regulatory state' has strongly influenced a parallel development at national level.

### **From centralised bureaucracy to independent agencies**

As already mentioned, one of the most obvious institutional consequences of the shift to a regulatory mode of policy-making is the rise of a new breed of specialised agencies and commissions operating at arm's length from central government. Many traditional policies, such as income redistribution and Keynesian

macroeconomic management, require a high level of centralisation in policy-making and administration. The administrative demands of rule-making are quite different. Such demands are best met by organisations which combine flexibility with expertise and are capable of committing themselves to clearly defined regulatory objectives.

Some advocates of the agency model argue as if this model were unconditionally superior to more traditional methods of making and implementing policy. This is not true, of course. For example, redistributive policies, or policies with significant redistributive implications, should remain under the direct control of political executives. The model of the independent expert agency is most relevant in limited, but important, areas such as economic and social regulation, or for other administrative activities where expertise, flexibility and reputation are the key to greater effectiveness.

In such areas, independent agencies enjoy two significant advantages: specialised knowledge and the possibility (because of independence from partisan political considerations) of making credible policy commitments. Also, the executive departments of government routinely recruit high-level experts and can rely on extensive networks of consultants. At the European level, the Commission is assisted by hundreds of expert committees providing essential scientific and technical inputs into the EC policy process.

The real comparative advantage of agencies, however, is the combination of expertise and commitment. Long-term policy commitment is notoriously difficult to achieve in a democracy, which is a form of government *pro tempore*. The time limit imposed by the requirements of elections at regular intervals is a powerful constraint on the arbitrary use by the winners of the electoral contest of the powers entrusted to them by the voters. However, the segmentation of the democratic process into relatively short time periods has serious consequences whenever the problems faced by society require long-term solutions. In the expectation of alternation, politicians have few incentives to develop policies whose success, if at all, will come after the next election. Hence, it is difficult for political executives to credibly commit themselves to a long-term strategy.

One solution is to delegate policy-making powers to institutions such as independent central banks and regulatory agencies, or even to a supranational authority like the European Commission. Whether at national or supra-national level, the rationale of delegation is essentially the same: '[t]he delegation of regulatory powers to some agency distinct from the government itself is...best understood as a means whereby the governments can commit themselves to regulatory strategies that would not be credible in the absence of such delegation. It is an open question in any particular case whether the commitment is most effectively achieved by delegation to national rather than to supranational agencies'.

### **Independence and credibility**

Credibility is important to policy makers, but it is even more important to bodies such as some of the new European agencies or national statistical offices, whose main task is to provide objective information or opinions based on the best available evidence rather than on political expediency.

In October 1993, agreement was finally reached on the establishment and location of several agencies dealing with social regulation: the European Environment Agency, the Agency for the Evaluation of Medicinal Products, the Agency for Safety and Health at Work, the Office for Veterinary and Plant-Health Inspection and Control, the Monitoring Centre for Control of Drugs and Drug Addiction. These new agencies do not possess the power of rule-making, rule enforcement and adjudication normally granted to American regulatory bodies, and even lack the more limited powers enjoyed by, for instance, Britain's Regulatory Offices or France's *Autorités Administratives Indépendantes*.

Council Regulation No. 1210/90 of 7 May 1990, for example, specifies the tasks of the European Environment Agency (EEA) as follows: to provide the Member States and the Community with information; to collect, record and assess data on the state of the environment; to encourage harmonisation of the methods of measurement; to promote the incorporation of European environmental information into international monitoring programmes; to ensure data dissemination; to cooperate with other Community bodies and international institutions.

Even the Agency for the Evaluation of Medicinal Products (EMEA), which comes closest to being a fully-fledged regulatory body, does not take decisions concerning the safety and efficacy of new medical drugs, but submits opinions concerning the approval of such drugs to the European Commission. Provision, coordination and dissemination of information are also central to the work of EMEA.

There are several reasons why the new European agencies have not been granted broader powers. First, the fully-fledged agency model raises delicate issues for European law since nothing in the founding Treaties provides for the creation of such bodies. Article 4 of the Rome Treaty lists the various institutions operating at Community level and specifies that each of them must act 'within the limits of the powers conferred upon them by this Treaty'. This has generally been read as a prohibition on the establishment of additional bodies, short of a Treaty revision. As early as 1958, the European Court of Justice indicated that the delegation of powers by Community institutions to *ad hoc* bodies not envisaged by the Treaty on the European Coal and Steel Community was only possible subject to strict conditions; in any event, the delegation of broad discretionary powers was not permitted. This 'Meroni Doctrine' is generally held to be applicable in the broader context of the Rome Treaty as well.

Another reason for not granting broader powers to

the new agencies is the emphasis that was laid down from the very beginning on an essentially legislative approach to integration. The Community adopts a legislative act which is subsequently transposed by the Member States into their own legal system and applied by their own administration. With some important exceptions in the areas of competition, anti-dumping, and agricultural policies, the Community has never departed from its traditional mode of decentralised administration. Hence, the delegation to autonomous bodies of rule-making and enforcement powers was always resented by the Member States as too intrusive, since it would alter the delicate balance of power which has presided over the growth of Community competences.

Moreover, the lack of a significant European tradition of statutory regulation by independent agencies certainly contributed to the reluctance of national governments to grant European agencies powers they were unwilling to delegate to domestic institutions. This may be changing, however, as the link between agency independence and policy credibility is more clearly recognised. Also, Member States may discover that agencies are an effective way of dealing with new tasks without increasing the size of the Commission. An analogous situation arose in America during the New Deal. The independence of the regulatory bodies created in that period – the Federal Communications Commission, the Securities and Exchange Commission, and the Civil Aeronautics Board, to name only a few – was the price President F.D. Roosevelt had to pay for acceptance by the US Congress and the Supreme Court of a significant expansion of federal competences. The President would have preferred to assign the new functions to executive departments under his immediate control, but the other branches of government were not willing to accept this.

For the time being at any rate, the new European agencies have weak regulatory powers, but this constraint could actually become an opportunity: with knowledge and persuasion as the principal means of influence at their disposal, the agencies could develop indirect, information-based modes of regulation more in tune with current economic, technological and political conditions than the coercive instruments of command and control that have been denied to them.

Information can affect expectations and behaviour only if it is credible, and credibility requires autonomy. This is why European statisticians have been demanding more independence, not only for the national statistical offices, but also for the statistical office of the EU, Eurostat. Thus, the Director-General of the National Statistical Institute of Italy, a vigorous advocate of the political independence of his own institution, has argued that the independence of Eurostat from political pressures, as well as from the immediate needs of policy-making, should be visible and operational *vis-à-vis* all relevant players, including the Commission. No single player, he writes, should have a monopoly

on statistical authority; impartiality should be operationalised in the relationship with all the different players, national and supranational.

Such concerns are both widespread and justified. Although the importance of independence for policy credibility is acknowledged in principle, habits of political and bureaucratic interference have deep historical roots in Europe, and often continue to persist in practice. To protect their autonomy, agencies must rely on a variety of defence mechanisms. Professionalism provides some protection. Professionals are oriented by goals, standards of conduct and career opportunities derived from their professional community, giving them strong reasons for resisting interference and direction from political outsiders. Networking and reputation are other important defence mechanisms.

### **The network as bearer of reputation**

Networking and close cooperation with national and international institutions are fundamental to the work of the new European agencies. The EEA, for example, is expected to work closely with national agencies and research institutions, with Eurostat and the Joint Research Centre, and with international agencies such as the World Health Organisation, UNEP, and the UN Economic Commission for Europe.

Similarly, the EMEA works closely with national regulatory authorities and, in particular, coordinates national activities with respect to post-marketing surveillance of medicinal products circulating in the EU (pharmacovigilance), inspection, and laboratory controls. The EMEA is also a key actor in the International Conference on Harmonisation of Technical Requirements for Registration of Pharmaceuticals for Human Use (the so-called ICH process), which brings together regulators and industry representatives from the US, the EU, Japan, and an increasing number of developed and developing countries.

In fact, the agencies have been designed in a way that makes cooperation and networking unavoidable. Both their governing boards and their scientific advisory boards are composed of representatives of the Member States, the Commission, and (in the case of the EEA, the EMEA, and the Monitoring Centre for Drug and Drug Addiction) of the European Parliament as well. At any rate, small size and limited financial and human resources make the new agencies heavily dependent on existing expertise and policy infrastructure. It is also very likely that one of the consequences of the greater emphasis on subsidiarity will be a considerable expansion of bilateral and multilateral cooperation and coordination among national regulatory bodies, leading to the emergence of more or less formalised network structures.

In recent years, management theorists have devoted a good deal of attention to the role of networks in industrial organisations, pointing out their usefulness in terms of information exchange, division of labour,

and informal coordination. Motivational factors have received less attention, but they are crucially important for regulatory networks. It is well known that teamwork can help individuals make credible commitments. Although individuals may be weak on their own, they can build resolve by forming a group. Any member of the group is open to peer pressure and thus places himself/herself in a situation where pride and self-respect are lost when commitments are broken. The success of organisations like Alcoholics Anonymous and Weight Watchers is built on this insight.

Now, what is true of individuals in a team is also true of agencies in a network. An agency that sees itself as part of a transnational network of institutions pursuing similar objectives and facing analogous problems, rather than as a marginal addition to an established bureaucracy pursuing a number of different objectives, is more motivated to defend its policy commitments and professional standards against external influences. This is because the agency executives have an incentive to maintain their reputation in the eyes of the other members of the network. Unprofessional or politically motivated decisions would compromise the executives' international reputation and make cooperation more difficult to achieve in the future.

But how is reputation established in the first place? By definition, a network is not hierarchically structured and so lacks formal mechanisms for monitoring the behaviour of its members and enforcing control. In time, however, the network develops informal standards and working practices that create shared expectations. Knowledge about agencies that do not fulfil the expectations of their partners spreads through the network by informal means. In this way, the network performs the crucial task of deciding which members are in good standing and communicating that information to other members. Only agencies with a reputation for independence, expertise and trustworthiness will be sought as partners. In short, the network becomes an intangible asset bearing a collective reputation and conferring that reputation upon the agencies in good standing. Independence, trust, reputation will be crucial to the viability of European regulatory networks, and thus to the practical implementation of the principle of subsidiarity in the areas of economic and social regulation.

### **Problems of institutional design**

There are different types of regulatory institutions. Such institutions can be single-headed (agencies in the narrow sense) or multi-headed (commissions, boards or tribunals), more or less independent of the political process, with broad or narrow competences, strong or weak enforcement powers, and so on. In establishing a new regulatory body, legislators and political executives select, often implicitly rather than explicitly, particular values for these and other decision variables. Their choices determine the governance structure of the agency.



Institutional-design problems may be analysed with the help of principal-agent theory. Political principals delegate power to an administrative agent in order to achieve certain benefits, but delegation also entails costs, known as 'agency costs'. The design problem is to find the particular governance structure which maximises the net benefits to the principal(s), subject to various constraints. As the preceding discussion suggests, among the benefits of delegation are a reduction in the principal's decision-making costs (since he does not have to spend time on the technical details of regulation), greater expertise, and greater policy credibility.

In general, the broader the delegation (i.e., the more independence given to the agency), the greater the reduction in decision-making costs and the increase in expertise and policy credibility. But delegation also expands administrative discretion and, therefore, the ability of regulators to act in their own interest. Such agency costs may be reduced by strict procedural requirements, transparency and public participation in agency decision-making, and reliance on judicial review. However, if it is not possible, for political or institutional reasons, to reduce agency costs sufficiently, or if the benefits of delegation are not great enough to justify the costs, then principal-agent theory suggests that policy should be developed and implemented by a central department of government rather than by an independent agency. This explains why the agency model is used primarily in the area of economic and social regulation, where the demand for expertise and policy commitment is high and where policy objectives can be defined fairly precisely, but not in less well-defined and more 'politicised' areas of policy-making.

Coordination costs must also be treated as agency costs whenever previously centralised responsibilities are allocated to various independent agents. Of course, coordination is a serious problem in all complex organisations, but it is especially acute in the case of regulatory agencies. This is because budgetary constraints have a limited impact on rule-making, while the size and priorities of non-regulatory, direct-expenditure programmes are determined by political executives through the budgetary process. By contrast, the real cost of regulations is borne not by the regulators but by the firms, individuals and government organisations which have to comply with the regulations. The consequence is a serious lack of coordination both within and across regulatory programmes and agencies.

Regulatory issues tend to be dealt with sector by sector, and even within the same sector it is often difficult to see that regulatory priorities are set in a way that explicitly takes into consideration either the urgency of the problem or the benefits and costs of different proposals. For example, the imbalance between water and air pollution existing in EC environmental policy can hardly be explained by differences in the seriousness of the relevant problems.

The health and environmental effects of inadequate regulation of air pollution, as well as the impact of divergent national regulations on competition, are no less serious than in the case of water pollution.

A cost that is never mentioned in the context of the principal-agent model is the potential loss of legitimation as a consequence of delegation. Political principals can transfer power to their agents, within limits set by law, but they cannot transfer legitimacy in the same way. The new institutions must be able to achieve their own legitimacy. This is, of course, no easy task. The technocrats who head independent agencies are appointed, not elected, officials, yet they wield considerable power. How is the exercise of that power to be democratically controlled?

Actually, this question arises not only for agencies but for all 'non-majoritarian institutions', i.e. institutions that, by design, are not directly accountable to the voters or to their elected representatives. Besides independent agencies, examples of non-majoritarian institutions include independent central banks, supranational institutions like the European Commission, and courts of law. Each of these institutions faces a legitimacy problem. The Commission, for instance, is often accused of suffering from a 'democratic deficit', and even a constitutional court must face the issue whenever it strikes down a policy choice made by an electorally accountable branch of government and supplants it with a policy choice of its own.

As in the case of other agency costs, it is possible to devise methods to reduce coordination problems and improve legitimacy. Thus, if lack of budgetary discipline is a serious defect of the regulatory process, one can attempt to create coordination and control mechanisms similar to those traditionally used for direct public expenditures. Following this line of reasoning, analysts of the American regulatory process have introduced the idea of a 'regulatory budget'. In its basic outline, the regulatory budget would be established by Congress and the President for each agency, starting with a budget constraint on total private expenditures mandated by regulation, and then allocating the budget among the different agencies. The knowledge that agencies would be competing against each other would lead them to propose their most cost-effective regulation in order to win presidential and congressional approval. Simultaneous consideration of all new regulations would permit an assessment of their joint impact on particular industries and on the economy as a whole. Finally, the placement of the regulatory budget decisions in the hands of Congress and the President would force them to assume responsibility for the overall magnitude and priorities of regulation and for inter-agency coordination. With suitable modifications, this approach could also be used in Europe, and would be particularly useful at EC level.

Concerning the legitimation problem, the challenge is to develop methods of democratic accountability

that do not negate the principle of agency autonomy. A literal interpretation of the requirement of direct accountability to the voters or to their elected representatives would suggest that political independence and democratic accountability are mutually exclusive. It is a mistake, however, to apply standards of legitimacy derived from a particular model of democracy – the ‘Westminster’ model, whereby Parliament is the absolute sovereign and, as such, the only source of legitimacy – to other political systems (and this includes the vast majority of Western democracies) where non-majoritarian institutions play a significant role. In such systems any mechanism for limiting, diffusing and controlling power (e.g., checks and balances, enumerated competences, judicial review) is a potential source of legitimacy.

Starting from this broader view of legitimacy, it is possible to keep independent agencies democratically accountable by a combination of control mechanisms: clear and narrowly defined objectives, to facilitate accountability by results; strict procedural requirements, to limit regulatory discretion; judicial review, to ensure protection of the rights of citizens; professionalism and peer review, to certify the technical quality of agency decisions; transparency and public participation, to make agencies responsive to public concerns. It can be shown that the evolution of regulatory agencies and decision-making in America has in fact been guided by these or similar principles. The experience of American regulatory bodies shows that when such a multi-pronged system of controls works properly, no one controls an independent agency, yet the agency is ‘under control’.

## RÉSUMÉ

### **Le modèle d'agence: la croissance de la régulation et des institutions régulatrices dans l'Union européenne**

*Les agences régulatrices sont l'expression institutionnelle d'un nouveau mode de conduite des affaires de l'Etat qui, plutôt que de s'appuyer sur le pouvoir traditionnel en matière de prélèvement des impôts et de dépenses, repose sur des règles destinées à faciliter l'intégration du marché et à corriger les échecs du marché. L'importance grandissante de la régulation dans la Communauté européenne/l'Union européenne (CE/UE) est due à deux grands facteurs: d'une part, les politiques de privatisation; d'autre part, l'impact des règles communautaires sur le processus d'élaboration des politiques au niveau national.*

*Tout d'abord, la privatisation des services publics s'accompagne généralement de la régulation des prix et conditions de service, alors que les entreprises nouvellement privatisées perdent leur immunité par rapport aux règles nationales et européennes en matière de concurrence. Dans les industries telles que les secteurs des télécommunications et de l'énergie, le pouvoir des nouvelles entreprises privatisées est tellement grand que les nouveaux concurrents ne*

*peuvent survivre qu'avec l'aide des instances régulatrices.*

*Deuxièmement, dans le système d'élaboration de politiques créé par le Traité de Rome, la mise en oeuvre de la plupart des règles communautaires relève de la responsabilité des Etats membres, qui souvent doivent instituer de nouveaux organismes ou du moins élargir à cette fin les organismes déjà en place. On le voit, le développement de la CE en tant qu' "Etat régulateur" a fortement influencé un développement parallèle au niveau national.*

*Une confiance toujours plus grande dans la régulation a donné naissance à une nouvelle génération d'organismes régulateurs qui opèrent tout près du gouvernement central. Cela s'explique par le fait que les besoins fonctionnels de régulation sont le mieux satisfaits par des organisations alliant flexibilité et expertise, et capables de s'engager sur des objectifs régulateurs à long terme. Les engagements à long terme en matière de politiques sont toujours problématiques pour tout gouvernement démocratique, étant donné que celui-ci est tout naturellement plus sensible aux préoccupations électorales. On voit dans cette délégation de pouvoirs régulateurs à des agences indépendantes un moyen permettant aux gouvernements de s'engager sur des objectifs à long terme qui ne seraient pas crédibles en l'absence de tels pouvoirs.*

*Pour leur part, les agences peuvent protéger leur indépendance et accroître leur propre crédibilité en établissant des réseaux avec des organismes régulateurs de nature similaire dans l'UE. Une agence qui se voit comme faisant partie d'un réseau transnational d'institutions poursuivant des objectifs similaires est davantage motivée pour défendre ses engagements de politique et ses normes professionnelles contre les influences extérieures. Des décisions non professionnelles ou motivées politiquement compromettraient la réputation internationale de l'agence et rendraient plus difficile une coopération à l'avenir.*

*Le modèle d'agence comprend un certain nombre de structures différentes de gouvernance. La nature d'une structure donnée est déterminée par des variables telles que le niveau de délégation de pouvoirs, le degré d'autonomie de l'agence, les méthodes de nomination du personnel cadre, les procédures décisionnelles, les pouvoirs d'exécution, et ainsi de suite. Le problème de la conception institutionnelle consiste à sélectionner la structure de gouvernance qui répond le mieux aux besoins particuliers des décideurs.*

## NOTES

<sup>1</sup> With the kind assistance of Adriaan Schout, Senior Lecturer, EIPA.

<sup>2</sup> During his stay at EIPA, Professor Majone is developing a multi-annual programme with Adriaan Schout aimed at analysing and comparing the design of European agencies. Two workshops, a publication and a database on European Agencies are planned for 1998. □