1. Introduction

INTRODUCTION

The last two decades have been characterized by profound changes in the political economy of European countries. In some domains, such as telecommunications and energy, public monopolies have been replaced by private ownership and free markets, and in many others, forms of liberalization have been introduced. While at first this was perceived as a wave of simple deregulation, scholars gradually realized that an important part of the process was about re-regulation: freer markets were accompanied by more rules (Vogel, 1996). A somewhat paradoxical consequence of liberalization, therefore, is that regulation has become an important part of public intervention in the economy. Against this background, Giandomenico Majone (1994; 1997a) even argued that the redefinition of the role of the state as an economic actor is so important that it actually amounts to a structural transformation in which regulation has become a central activity of governments. The thesis that a regulatory state has emerged across Europe has been very influential and has made regulation an important field of study for European political scientists. Although Majone’s view of a homogeneous structural trend has been nuanced and also contested, many recent works have reaffirmed the central place of regulation in modern governance. Some authors have argued that the rise of regulation in public policy represents a major transformation not only of the state but more broadly of the way the economy is organized, so that we can speak of a new model of ‘regulatory capitalism’ (Levi-Faur, 2005b, 2006a).

Regardless of labels, there is little question that regulation has acquired unprecedented importance in the governance structures of European states. This book examines the institutional foundations of this new model. In effect, the rise of regulation has been accompanied by the rise of a new type of institution, namely the independent regulatory agency. The characteristics of regulatory agencies, of course, vary considerably from one country to another, as well as across regulatory domains, but their common feature is that they have been deliberately insulated from political control. When faced with the new tasks of regulation, most governments have set up specialized authorities and set them outside the ‘chain of delegation’ that runs from voters to the administration via parliament.
and government (Strøm, 2000; Strøm et al., 2003). This model is not entirely new: independent regulatory agencies have long existed in the United States and in Europe they are already well established in some sectors, such as banking and financial markets. However, they have exploded since the end of the 1980s, and have now become a common institutional model in all European countries. This trend is shown in Figure 1.1, where the vertical axis represents the percentage of country-sectors in European countries where an independent regulatory agency has been established. While in 1980 independent regulators existed in only about 10 per cent of country-sectors in Western Europe, this percentage had risen to almost 80 per cent two decades later. On the one hand, the observation by the OECD that ‘one of the most widespread institutions of modern regulatory governance is the so-called independent regulator or autonomous administrative agency with regulatory powers’ (OECD, 2002: 91) is correct, but could not have been made even ten years ago. On the other hand, Figure 1.2 shows that although the trend towards the establishment of independent regulators concerns all West European countries, there are significant differences in the extent to which regulatory agencies are formally independent from elected politicians. On average, regulators
are more than twice as independent in Ireland and in the United Kingdom than in Germany and Switzerland.

This book approaches these issues by asking two questions. First, why have governments chosen to delegate regulation to authorities that they can only in part control? Second, why did independent regulatory agencies spread so spectacularly during the 1990s? To answer the first question, the book develops theoretical hypotheses on the role of credible commitment capacity, political uncertainty, and political institutions in regulatory policy making. Empirically, it examines the formal independence of regulators in 17 European countries (the 15 members of the European Union before enlargement, plus Switzerland and Norway) and in seven regulatory domains (telecommunications, electricity, financial markets, competition policy, food safety, pharmaceuticals and the environment).

As the analysis will show, the comparative pattern of delegation suggests that policy makers delegate so as to increase the credibility of their policy commitments, and also to tie the hands of future policy makers who may have different preferences. To answer the second question, the book inquires whether the establishment of independent regulators was only a response to these pressures, or whether it was also characterized by

Figure 1.2  The formal independence of regulators in Western Europe (country averages)
a diffusion process whereby decisions to delegate regulation to independent authorities have been interdependent.

The empirical findings show that country-specific factors matter: the explosion in the number of independent regulators in the 1990s is due in part to the need to regulate newly created markets, as well as to the political and institutional context of each country. However, these authorities have not been invented autonomously in each country: the model of the independent regulator has diffused internationally. At the beginning of the twenty-first century, independent regulatory agencies are widely accepted as an appropriate institutional model for modern regulatory policies. This conclusion, however, does not necessarily imply that independent regulators are in fact a better model: their spread may have more to do with their legitimacy in the international arena than with their actual consequences for regulatory policy making.

In the rest of this introduction we will first preview the main arguments, then discuss its contribution to the literature, and finally introduce the structure of the coming chapters.

THE ARGUMENT OF THE BOOK

Theory

At the theoretical level, the book argues that delegation to authorities that are formally independent from elected policy makers cannot be explained from a standard principal–agent perspective (Bendor et al., 2001; Gilardi and Braun, 2002). In contrast to the principal–agent view, delegation to independent regulators is characterized by a violation of the ‘ally principle’ (the agent should be selected so as to be as similar in preferences to the principal as possible) and of the conclusion that the more the agent’s preferences deviate from the principal’s, the more developed ex post controls should be. Although formal independence, of course, does not imply the absence of control (McCubbins and Schwartz, 1984), independent regulatory agencies hardly fit the standard principal–agent view of delegation. Rather, the chapter develops three main arguments.

First, the preferences of policy makers may change over time, weakening the credibility of policy commitments (Kydland and Prescott, 1977). In some cases, this is a problem because the capacity to make credible commitments is an important political asset. This is especially the case for utilities regulation, where the main goal is to create and maintain a well-functioning market. One of the conditions is attracting private investment, which is sensitive to the instability of policy decisions. Therefore, delegation
to independent regulatory authorities may increase the credibility of regulatory commitments, in economic regulation in general but especially in utilities regulation. Second, while solving the credibility problem is about self-binding, insulating regulatory policy from politics may also be a means of tying the hands of future policy makers. In democracies, elected officials are bound to be replaced, sooner or later, by opponents that may change policies at their discretion. This is known as the political uncertainty problem (Moe, 1990). Delegation to independent regulators may be a means of limiting the discretion of future policy makers, and therefore of increasing the duration of policy choices. Third, the institutional context matters because it influences policy stability and, therefore, both the credibility and the political uncertainty problems. More specifically, veto players (Tsebelis, 2002) should be related to delegation to independent regulatory authorities since, by making policy change more difficult, they tend to mitigate the two problems. In this sense, veto players could be seen as functional equivalents of delegation. Patterns of delegation to independent regulatory agencies should thus be expected to vary systematically according to countries’ institutional characteristics.

The second major question in the book relates to the timing of the establishment of independent regulators: why the majority of them were established in a relatively short time span in the 1990s. To answer this question, the three factors we have just mentioned can be expected to matter: credibility pressures have probably increased since the mid-1980s, notably as a consequence of privatization and liberalization processes, and political uncertainty and institutions may also have played a role. However, the main hypothesis developed in this context is that the establishment of an independent regulator in a given country and sector is not independent from previous similar decisions in other countries and sectors. In other words, interdependence matters and independent agencies can diffuse internationally. Interdependence and diffusion can take different shapes (Simmons et al., 2006; Braun and Gilardi, 2006c). Policy makers may learn by observing the consequences of policy choices elsewhere, revise their beliefs on the desirability of the policy on this basis and act accordingly. But they can also be influenced by less rational considerations. In particular, the sociological literature on the diffusion of practices and organizations suggests that some forms can progressively become socially valued and legitimate and viewed as appropriate, regardless of their actual consequences. Organizational choice can be a ‘ceremony’ whose goal is to gain legitimacy more than to solve problems, and some organizational forms can even become so widely accepted that their appropriateness is taken for granted, while alternatives disappear from the radar screen of decision makers. Similar arguments have been advanced to account for the spread of
independent central banks, and normative pressures from the European Union, the OECD and other institutions suggest that the diffusion of independent regulators may have followed a similar pattern. In sum, the main theoretical argument to account for the spread of independent regulatory agencies is that although country and sector-specific pressures certainly matter, there has been an interdependent diffusion process where the symbolic characteristics of independent agencies have played an important role.

Methodology

The book compares regulators in 17 countries and seven sectors, and the analysis is quantitative. Two dependent variables are examined: the formal independence of regulators and their date of creation. The dataset is original, and was constructed through primary data collection. Questionnaires were sent to regulators and printed and online annual reports and legislative documents were consulted. To measure formal independence, an independence index is constructed, which varies continuously between 0 and 1. To analyse the data, ordinary least squares (OLS) is not an appropriate estimator because a significant number of observations are clustered on 0. In other words, in some cases regulators are not independent at all because no independent authority exists. To account for this data structure, a Tobit model is used (Sigelman and Zeng, 2000). While this part of the analysis is purely cross-sectional, that of the date of establishment is longitudinal. For each country-sector, the dependent variable takes the value of 0 for every year until an independent regulator is established. The dependent variable is coded 1 for the year of creation, and observations are then dropped. Given this data structure, event-history methods are employed (Box-Steffensmeier and Jones, 2004).

Although the analysis is purely quantitative, the concluding chapter discusses strategies to go back to cases on the basis of the statistical results, following the 'nested analysis' logic put forward by Lieberman (2005). The idea is that the quantitative analysis permits the identification of 'interesting' cases for case studies, and the construction of comparisons of cases that correspond to method-of-difference or method-of-agreement designs (Mill, 1895; Przeworski and Teune, 1970). The conclusion briefly discusses one ‘interesting’ case, the late establishment of the German energy regulator, and suggests other cases for future qualitative studies.

Findings

The main results of this research can be summarized as follows. Credibility, political uncertainty and political institutions matter for delegation to
independent regulatory agencies. First, regulators tend to be formally most independent from elected politicians in utilities, and more independent in other economic regulation than in social regulation. This is consistent with the credibility hypothesis, because incentives to make regulatory policies more consistent over time are greatest when utilities are liberalized and lowest in social regulation, while economic regulation is in-between the two. Second, the formal independence of regulators tends to increase with replacement risk, specifically the probability for a government to be replaced by one with different preferences. This is consistent with the political uncertainty hypothesis, which argues that delegation to independent authorities can be a means for policy makers to tie the hands of their successors. Third, regulators tend to be more independent in countries with few veto players, which is consistent with the argument that an institutional context that makes policy change difficult is a functional equivalent of delegation because it mitigates both the problems of credibility and of political uncertainty. However, the analysis of central bank independence shows that central banks tend to be more independent in countries with many veto players, consistent with the view that delegation itself is not credible unless there are obstacles to its withdrawal. The comparison of regulatory agencies and central banks thus leads to puzzling results.

These findings are confirmed in the longitudinal analysis of the establishment of independent regulators. Independent regulatory agencies are more likely to be set up when utilities are liberalized or privatized, where the replacement risk is high, and where the institutional context makes policy change easier. In addition, the longitudinal analysis finds that veto players moderate the impact of both liberalization and of replacement risk, and that the latter has a greater effect on the probability that an independent agency is established in countries where replacement risk is usually low, which is consistent with theoretical expectations. The European Union has also played an important role: in the telecoms domain, Member States were much more likely to set up independent regulators when they had to implement a directive requiring the separation of ownership and regulation. The main result of the longitudinal analysis is, however, that independent regulatory agencies have spread in an interdependent diffusion process. The establishment of an independent regulatory agency in a given country and sector is in part influenced from previous decisions in other countries and sectors. Ceteris paribus, the higher the share of country-sectors where independent agencies have already been established, the higher the probability that a new independent regulator will be set up. Following the sociological literature, this evidence is consistent with the idea that the diffusion process is driven by emulation, where the actual consequences of delegation matter less than its symbolic properties. Independent regulatory agencies seem to
have become a widely accepted institutional model, regardless of their consequences for regulatory policy making.

CONTRIBUTIONS TO THE LITERATURE

This book improves on the current state of research in several ways. The first contribution is to supply a broad mapping of independent regulatory agencies in Europe. While the situation has recently started to change (see for example Jordana et al., 2007), systematic mappings of independent regulators are scarce, since most studies have so far relied on detailed studies of a few cases (see for example Thatcher, 1998, 2002a; Döhler, 2002; Wilks and Bartle, 2002; Gehring, 2004). These works have permitted the generation of fine-grained knowledge of independent regulators in the cases they study, but they inevitably miss the larger picture. In this context, supplying comparative information on delegation to independent regulatory agencies is a useful complement to existing work. This book therefore takes some distance from the trees and looks at the forest; however, we will see in the conclusion that the findings also permit the return to cases with a strong analytical focus. In sum, while the emphasis of this research is clearly on the search for systematic patterns among a large number of cases, the book builds on the qualitative research developed so far and supplies some criteria and arguments to select interesting cases for further qualitative work. In this sense, this book is strongly anchored in the collective research agenda on regulatory agencies in Europe.

To achieve the goal of a broad and systematic comparison, several intermediary steps are necessary, which are in themselves significant contributions to the literature. The operationalization of formal independence is the most important point. The defining characteristic of independent regulatory agencies is precisely their independence: the fact that they cannot be directly controlled by elected officials, or to use a catch phrase, that they are at arm's length from politicians. But not all arms have the same length. Independence is not all-or-nothing; intermediate degrees exist. Indeed, explaining why some agencies are more independent than others is one of the main aims of this book. But how do we know whether one regulator is more or less independent than another? In this book I present an index of formal independence from politicians based on the independence index developed for central banks (in particular Cukierman et al., 1992). It is not an all-purpose index. It focuses exclusively on the formal aspects of independence from elected politicians, and neglects important points such as independence from regulated firms, as well as informal dimensions of independence. Despite these limitations, it is appropriate to investigate the
political act of delegation. Researchers who are interested in the effects of delegation rather than its origins should, however, be encouraged also to take into account other facets of independence. At any rate, the empirical information on formal independence presented in this book constitute the most extensive dataset on the institutional characteristics of regulators in Europe, and should be a useful starting point for many studies of independent agencies.

Another contribution of the book is to extend the range of the comparison not only across countries, but also across sectors. Many studies concentrate on a single sector, and when they do compare sectors, these are usually telecoms and electricity, and in some cases competition or financial services. Regulators in social regulation, that is, domains where regulation deals with issues such as safety and health instead of prices, entry, exit and service of an industry (which is conventionally termed economic regulation) are seldom studied, and virtually never compared with regulators in the economic domain. Yet cross-sectoral comparisons can be very fruitful. Although the research design is quantitative and therefore does not follow the ‘stepwise’ approach put forward by Levi-Faur (2006b), the book does take advantage of cross-sectional variations in delegation patterns, showing that sectoral characteristics are very important, and not only national specificities.

The focus on diffusion is another strong point of the book. While in the age of globalization it has become common to recognize that countries have become more interdependent than ever, the consequences of this observation are seldom drawn. Increased interdependence means that the implicit assumption made in many studies that policy choices in one country are not influenced by previous choices in other countries has become very implausible and difficult to sustain. Furthermore, interdependence means that policies can spread internationally, which is an interesting phenomenon that deserves consideration. This book takes these arguments seriously and puts them in the context of the recent and rapidly-growing diffusion literature in political science (see for example Simmons and Elkins, 2004; Simmons, Dobbin and Garrett, 2006; Swank, 2006; Jordana and Levi-Faur, 2005; Levi-Faur, 2005b; Meseguer, 2004, 2006a; Gilardi, 2005b; Braun and Gilardi, 2006c). Although the empirical application is relatively simple, it prepares the ground for further studies of the diffusion of policies and institutions well beyond the case of independent regulatory agencies.

Finally, at the theoretical level the book blends a variety of arguments developed in various contexts, and thus also bridges several bodies of literature. To analyse the formal independence of regulators, it builds on theories of delegation developed in the United States (see for example
McCubbins, 1985; McCubbins et al., 1987; Horn, 1995; Epstein and O’Halloran, 1999; Moe, 1997; Bendor et al., 2001; Huber and Shipan, 2004) and applies them in Europe, joining a growing literature that has fostered this cross-fertilization (see for example Pollack, 2002; Huber and Shipan, 2002; Strøm et al., 2003; Franchino, 2004; Braun and Gilardi, 2006a). The book links two related but hitherto largely disconnected literatures: that on regulatory agencies and that on central banks (see for example Goodman, 1991; Bernhard, 1998; Eijffinger and Schaling, 1998; Elgie, 1998; Lohmann, 1998; Keefer and Stasavage, 2002, 2003). In addition to using the latter to develop an index of formal independence, this work also compares explanations of delegation in these two contexts, especially with respect to the institutional context. As the findings show, patterns of delegation to regulators and to central banks tend to diverge, despite the many similarities in these two types of independent authorities. Finally, the book combines rational-choice theories of delegation with sociological arguments about the diffusion of socially legitimate organizational structures, and in the process injects a longitudinal (and with a few exceptions, largely absent) dimension into the study of delegation (Jordana and Levi-Faur, 2005; Jordana et al., 2007; Polillo and Guillén, 2005). In sum, by consolidating several approaches in a coherent analysis, this book gives a rich and theoretically relevant view of delegation in the regulatory state that not only supplies important answers, but also opens up interesting avenues for future research.

THE STRUCTURE OF THE BOOK

The rest of the book is structured as follows. Chapter 2 introduces in more detail independent regulatory agencies as the institutional foundations of the regulatory state and of regulatory capitalism. Independent regulatory authorities are governmental bodies that exercise public authority but which are neither elected nor directly controlled by elected policy makers. They are the major characteristics of what has been called the rise of the ‘regulatory state’ (Majone, 1997a) or of ‘regulatory capitalism’ (Levi-Faur, 2005b, 2006a). The chapter develops these concepts, discusses their empirical relevance to European countries, and shows how independent regulators are the primary institutional characteristic of the rise of regulation as a prominent instrument of public action.

Chapter 3 develops theoretical explanations of delegation patterns, or in other words why some regulators are formally more independent of elected politicians than others. The chapter first exposes the limits of standard principal-agent explanations, and then discusses the problems of credibility
and political uncertainty and their relevance for delegation to independent agencies in Europe. The chapter also explores the role of political institutions, and shows how the regulation and central banks literatures disagree on this point.

Chapter 4 examines these arguments empirically. It discusses the formal independence of regulators and its operationalization through an independence index based on that for central banks; it illustrates variations in formal independence both across countries and across sectors; and it presents the results of the statistical analysis, which confirm the hypotheses presented in the third chapter. In addition, the chapter compares independent regulators with central banks, especially with respect to the role of the institutional context, which appears to matter in both cases, but in different ways. While veto players work as functional equivalents of delegation to independent regulators, they are a precondition for credible delegation to central banks, as argued in the central banks' literature.

Chapter 5 introduces the interdependent dimension of delegation to independent regulatory agencies. While Chapters 3 and 4 concentrate on country-specific factors, this chapter adds a diffusion perspective to the study of delegation to independent agencies by looking at the ways in which delegation in one country and sector is influenced by delegation in other countries and sectors. It introduces the relevant literature on diffusion, convergence and transfer, and then conceptualizes policy diffusion as a process whereby policy choices are interdependent. The chapter then discusses the various forms this interdependence can take, and shows that several diffusion mechanisms may exist, such as learning, competition, symbolic imitation and taken-for-grantedness. The chapter devotes special attention to the last two, which are linked to the idea that some policies or institutional forms may spread, not because of their consequences for the outcomes of policy making but rather, because they have become accepted as appropriate and socially legitimate mechanisms. The diffusion of independent agencies, therefore, may partly be attributed to their ability to achieve a socially valued status that may not be linked to their actual effects on regulation.

Chapter 6 examines diffusion hypotheses empirically in a longitudinal analysis of the establishment of independent regulatory authorities. First, it describes how the establishment of independent regulators has followed an explosive trend in which many agencies were set up in a relatively short period of time. Second, the results of the analysis show that, in addition to the factors already studied in Chapters 3 and 4 (which can be thought of as ‘independent problem solving’), diffusion matters. The choices to establish independent regulators have been interdependent. In particular, independent regulatory agencies have been progressively taken for granted as the
appropriate institutional design for regulatory policies, and have also been set up to legitimize the actions of policy makers. Processes at the European Union level have also favored the trend, particularly in the telecommunications sector.

The concluding chapter summarizes the findings, reiterates their relevance, and outlines avenues for future research. In particular, it discusses how the quantitative analysis can be used to identify ‘interesting’ cases for qualitative investigation, and argues that future research should concentrate on issues such as the informal aspects of independence, the consequences of both formal and informal independence regulatory processes and outcomes, and the unpacking of the diffusion process that has led to the spread of independent regulatory agencies across countries and sectors.