Delegation and Accountability in Parliamentary Democracies

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Delegation and its Perils

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INTRODUCTION

Delegation is a central concept in the conduct and the study of politics. Governments great and small use delegation to increase the range of services that they can provide. National governments, for example, delegate to defence ministries the task of maintaining national security and delegate to finance ministries the task of managing the economy. Indeed, the modern nation-state could not exist without delegation—for without delegation, lawmakers would be forced personally to implement and enforce every single law that they make. With delegation, national governments can address a wide range of social issues simultaneously.

In most polities, the most prominent form of delegation is from lawmakers (e.g. parliaments) to government agencies (e.g. economic, security, and public welfare agencies). Such agencies house the persons responsible for enforcing laws and tend to employ the nation's leading experts in the agency's policy area (e.g. economic agencies employ leading economists). In many places, these agencies are known collectively as *the bureaucracy*. In some places, people who work within these agencies are called *bureaucrats* or *civil servants*.

We define delegation as an act where one person or group, called a *principal*, relies on another person or group, called an *agent*, to act on the principal's behalf. This volume's purpose is to examine delegation problems that exist in parliamentary democracies. Table 2.1 displays prominent forms of delegation in these democracies.

Delegation allows political principals to accomplish desired ends with reduced personal cost and effort. Implementing a single ministerial directive, for example, can require more time and effort than any minister can muster. Only by delegating—getting subordinates to do most of the work—can any high-level government official achieve multiple objectives. Similarly, most citizens are not sufficiently qualified to provide the social services that improve their lives (e.g. education, health care). Only by delegating—getting specialists to do most of the work—can any citizen enjoy such services.

Table 2.1. *Common Forms of Delegation*

Principal	Agent
Voter	A Member of Parliament and/or a party (depending on the ballot list system)
Members of Parliament, Parties	The government
Government	Cabinet Ministers
Cabinet Ministers	Civil Service
Civil service directors	Civil service employees

While delegation allows principals to benefit from the expertise and abilities of others, it can also be perilous. The perils arise from the fact that delegation entails a transfer of power—every time lawmakers delegate to bureaucrats, they give away a portion of their authority to govern. A great danger is that the people to whom power is delegated will abuse the power they receive. Consider, for example, Weber's famous treatise about what happens when legislatures delegate to bureaucrats:

Under normal conditions, the power position of a fully developed bureaucracy is always over-towering. The 'political master' finds himself in the position of the 'dilettante' who stands opposite the 'expert', facing the trained official who stands within the management of administration. This holds whether the 'master' whom the bureaucracy serves is a 'people', equipped with the weapons of 'legislative initiative', the 'referendum', and the right to remove officials, or a parliament, elected on a more aristocratic or more 'democratic' basis and equipped with the right to vote a lack of confidence... (Weber, quoted in Gerth and Mills 1946: 232)

If this danger is realized, then those entrusted with the responsibility of governing lose control of what is done in the government's name and anarchy can ensue.

While delegation is not a perfect means for political principals to achieve their objectives, it is the only feasible means. Anyone who wants to govern or provide services to mass populations must find agents to carry out their plans. Therefore, understanding the relations between principals and agents is critical to answering many questions about parliamentary governance.

In this chapter, I present a theoretical framework that clarifies when principals can, and cannot, use delegation to accomplish desired ends. I use the framework to clarify how a number of factors, including political institutions, affect the success of delegation. In subsequent chapters, other authors use the framework to examine the empirical relationship between delegation and accountability in 17 West European parliamentary democracies.

I continue as follows. In the section titled Measures of What Delegation Accomplishes, I offer important definitions and terms. In the section that follows, I introduce the theoretical framework. In the section on the Consequences of Delegation, I use the framework to clarify when agents will act in their principals' interests. In section titled How Institutions Affect Agency Loss, I explain how political institutions can alleviate the perils of delegation. In the conclusion, I link this chapter's insights to broader questions.

MEASURES OF WHAT DELEGATION ACCOMPLISHES

In this section, I introduce needed definitions. I begin by defining delegation and accountability. Delegation, as noted in this chapter's opening sentences, is an act where one person or group, called a *principal*, relies on another person or group, called an *agent*, to act on the principal's behalf. Defining *accountability* is not as simple.

People use the term *accountability* to characterize the effectiveness or efficiency of governance, in general, and delegation acts, in particular. A problem with the term is that it is used in different ways. For some, accountability is *a process of control*. In this view, civil servants are accountable to ministers only if the ministers can influence a civil servant's actions. For others, accountability is *a type of outcome*. In this view, civil servants are accountable to ministers only if the agent acts in the minister's interests.

The 'control' and 'outcome' definitions of accountability mean different things. A civil servant can provide outcomes that a minister likes without the minister exercising any control. This happens when a civil servant and minister share the same policy goals, the civil servant completely ignores ministerial directives, and pursuing her own interests leads her to take actions that favour the minister nevertheless. Conversely, a minister can exercise great control over a civil servant without achieving a desired outcome. This happens when a minister can remove a civil servant if a certain level of service is not achieved and the servant lacks the skills needed to achieve the goal.

This book adopts the 'control' definition of accountability. An agent is accountable to a principal if the principal can exercise control over the agent and delegation is not accountable if the principal is unable to exercise control. If a principal in situation A exerts more control than a principal in situation B, then accountability is greater in situation A than it is in situation B.

Having defined accountability in this way, I should now restate this chapter's goal. In what follows, I will clarify what delegation accomplishes by using a theoretical framework to examine how common processes of control (i.e. the rules or institutions under which delegation commonly occurs) affect the outcome of an act of delegation.

To describe outcomes, I employ two metrics—agency loss and success/failure. *Agency loss* is the difference between the actual consequence of delegation and what the consequence would have been had the agent been 'perfect'. By perfect, I mean a hypothetical agent who does what the principal would have done if the principal had unlimited information and resources to do the job herself.

Agency loss describes the consequence of delegation from the principal's perspective. To say that agency loss is high is to say that the outcome of delegation is different from the principal's ideal outcome. To say that agency loss decreases is to say that the outcome of delegation moves closer to the principal's ideal.

The agency loss metric, though simple, is easy to misinterpret. Agency loss is zero when the agent takes actions that the principal would have taken *given unlimited information and resources*. If people forget this fact when using the agency loss metric, then delegation often seems to be a bad idea (e.g. 'This act of delegation caused agency loss. Therefore, it is bad.'). However, most political principals do not have unlimited information and resources. Therefore, it is impossible for them to be perfect agents for

themselves (e.g. doctors are agents that are employed to maintain good health; consider what would happen if you tried to serve as your own doctor). Indeed, many principals who try to do all that agents can do will experience delegation outcomes far inferior to the ones that a hypothetical perfect agent would provide. Therefore, finding that delegation causes agency loss does not imply that the outcome is bad or even suboptimal.

A coarser metric for describing delegation outcomes is success and failure. Delegation is *successful* if the outcome of delegation improves the principal's welfare relative to what would have happened if the principal had chosen not to delegate. Following common parlance, I call the consequence of an agent's inaction the status quo. Delegation *fails* if it decreases the principal's welfare relative to this status quo.

Throughout the chapter, I use both metrics to describe delegation outcomes. I use agency loss when I want to make comparative statements about how differences between the principal and agent or variations in political institutions affect the degree to which the outcome of delegation reflects the principal's desires. I use the success/failure metric when I want to make simple statements about whether or not an act of delegation makes the principal better or worse off than the status quo.

I should also note that my use of the term status quo is equivalent to the common usage of the term *reversion point*. That is, if the agent fails to act, then the outcome of delegation *reverts* back to the status quo. While I will stick with the term status quo, authors of some later chapters prefer the term reversion point to mean the same thing.

THEORETICAL FRAMEWORK

I now introduce a framework that clarifies the relationship between delegation, mechanisms of accountability, agency loss, delegation success, and delegation failure. The framework builds on three simple premises.

1. *Parliamentary democracy entails a chain of delegation*
In such a chain, each link attaches a principal to an agent. The ideal–typical delegation chain resembles a straight line and includes a link: that attaches voters to members of Parliament; a link that attaches members of Parliament to the government; a link that attaches the government to individual ministers; and a link that attaches ministers to civil servants. In other words, citizens occupy one end of the ideal–typical chain while civil servants who implement government edicts occupy the chain's other end. In this view, the effectiveness of institutional accountability mechanisms can be measured by the extent to which agents at one end of the chain 'feel a tug' when principals at the other end 'pull the chain'.

Of course, most parliamentary democracies are not simple, singular delegation chains. Sometimes multiple principals delegate to a single agent or prin-cipals grant agents overlapping jurisdictions. Such practices change a chain of delegation's shape. Since most countries engage in such practices at least some of the time, we observe delegation chains varying widely in size and shape when we compare democracies empirically. Such variations are a product and a cause of each country's unique experience

with democracy. It is, however, important to note that alongside such differences are common properties that all delegation chains share, which leads to our framework's second premise.

2. Common properties make general conclusions possible
Three such properties are as follows:

- Every delegation involves a principal and an agent.
- Many delegations entail *the possibility of conflicting interests*.
- Many delegations contain *the possibility of limited information*.

While the first of these properties is obvious, the latter two require explanation. The possibility of conflicting interests implies that the agent need not have the same policy objectives or prefer the same outcomes as principals. An agent may want to help the elderly while his principal detests them (i.e. the principal and agent desire different policies). A principal may prefer that an agent work hard on a complex problem, while the agent may prefer to spend afternoons fishing or at a bar (i.e. the principal and agent may desire the same policy but differ in who should exert effort to achieve that policy objective). Either difference is important because each can provide an agent with reasons to act contrary to his principal's desires.

The possibility of limited information implies that the principal, agent, or both are not omniscient. When an agent lacks information, one possible result is incompetence (e.g. the agent does not know how to do what a principal asks). Students of politics, however, pay much more attention to what happens when principals lack information. Indeed, it is commonly assumed that political principals, particularly voters and backbench MPs, are ignorant of their agents' activities. Our treatment of how limited information affects delegation will share this focus—we shall concentrate primarily on what happens when the principal lacks information about what her agent is doing.

While these three common properties are far from a complete description of any delegation act, they are sufficient for us to derive some important results what delegation accomplishes later in the chapter.

3. Formal models provide important insights
The relationships between principals and agents can be complex. When attempting to derive the properties of complex systems, logical devices such as formal models can be helpful ways to derive simple insights from complex observations. In several areas of political science and economics, formal models have helped scholars better understand the relationship between institutions, information, and political decision-making (e.g. Williamson 1975; Shepsle 1979; North 1981).

In the following two sections, I will use a framework built on these three premises to clarify what delegation accomplishes. I will highlight factors that cause agency loss and I will describe the conditions under which well-known accountability mechanisms can reduce agency loss. In the following chapters, the volume's contributors will use this same framework as the foundation of a wide array of empirical analyses.
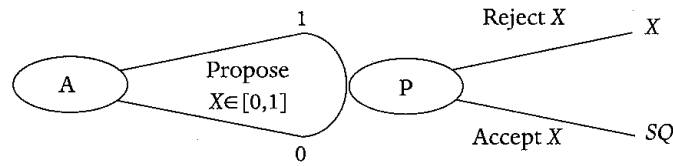
Figure 2.1. A Delegation Model.

THE CONSEQUENCES OF DELEGATION

I now use insights from several formal models to clarify what delegation accomplishes. I begin with a simple model that focuses on a single act of delegation. While this model has origins in economics (e.g. Niskanen 1971), the version I present is due to Romer and Rosenthal (1978). The sequence of events in their model is as follows and as depicted in Fig. 2.1.[1]

Romer and Rosenthal model an act of delegation as a game between a principal and an agent. To simplify my explanation of this and subsequent models, I henceforth refer to the principal as a female and the agent as a male. In the Romer–Rosenthal model, the agent moves first by choosing whether or not to change what was done in the past (i.e. the agent chooses whether or not to act). A civil servant, for example, acts when he interprets a government directive differently than it had been interpreted before. Put another way, Romer and Rosenthal study an act of delegation after the principal has already chosen to delegate.

Romer and Rosenthal conceive of the agent's possible actions as points on a line. They represent the agent's choice of action as the choice of a point, X, on the line [0, 1]. This choice may or may not be the same as the pre-existing status quo—denoted as $SQ \in [0, 1]$. SQ represents the outcome of delegation when the agent chooses not to act.

After the agent chooses whether or not to act and, if so, which action to take, the principal reacts by accepting the action or rejecting it in favour of the status quo (i.e. the principal chooses X or SQ). You can think of the principal's decision to reject the agent's action as an outright veto of an agent's decision or as a sanction against the agent that is sufficient to induce him to undo what he has done.

Romer and Rosenthal assume that the principal and agent have preferences over the possible outcomes of delegation. These preferences are represented by assuming that each player maximizes a single-peaked utility function. The peak of each player's utility function is his or her ideal policy. So it is equivalent to say that each player's objective is to achieve a delegation outcome that is as close as possible to his or her ideal policy.

I denote the principal's ideal policy as $P \in [0, 1]$ and the agent's ideal policy as $A \in [0, 1]$. Given our definition of agency loss and this notation, we can also say that P, the principal's ideal policy, is the point at which agency loss is zero. Agency loss grows as does the distance between P and the final outcome of the principal's and agent's interaction.

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[1] Throughout the chapter, I present theoretical insights with a minimum amount of mathematical notation. For those interested in the mechanics of these theories, I provide citations throughout the text. Some of the material in this section follows directly from an argument first published in Lupia (2000).

```
Situation 1
                *
_____
   SQ        P = A

Situation 2
         *
_____
   SQ A     P

or
                        *
_____
   SQ       P     A

Situation 3
                        *
_____
   SQ       P                   A

Situation 4
            *
_____
   A*       SQ            P
```

Figure 2.2. Graphical Depictions of the Possible Situations. The star indicates the predicted outcome of delegation in the (complete information) Romer and Rosenthal model.

A key assumption in the Romer–Rosenthal model is that the principal and agent have complete information. This assumption simplifies the model considerably and allows important insights to be derived efficiently. After stating these results, I will describe other models where limited information plays a key role.

The Romer–Rosenthal model reveals fundamental causes of agency loss. It does so by separating four mutually exclusive and collectively exhaustive situations. Each situation provides a distinct insight about the optimal actions of principal and agent given their beliefs about the other's response. I depict each situation in Fig. 2.2.

In situation 1, the principal and agent have identical ideal policies. As a result, they are in perfect agreement about what the agent should do. Thus, the model predicts that agent proposes the principal's (and his own) ideal policy and the principal accepts it. In this situation, there is no agency loss.

In all other situations, the outcome of delegation is different. That is, in any case where the principal and agent do not have identical ideal points, the outcome of delegation in the Romer–Rosenthal model entails some agency loss. In situations 2 and 3, for example, the principal and agent have different ideal policies, but both players' ideal policies are on the same side of the status quo. In these situations, the principal and agent agree on the desired direction of policy change but not on the magnitude of change (e.g. both prefer higher taxes but disagree on the rate of increase).

In situation 2, the principal's ideal policy is farther from the status quo than it is from the agent's ideal policy. In other words, this is the case where the principal prefers the agent's ideal policy, A, to the status quo, SQ. In this situation, the Romer–Rosenthal model predicts that the agent chooses his ideal policy and the principal accepts the agent's action. This occurs because the agent knows that the principal prefers some degree of change (i.e. A) to no change at all (i.e. SQ). The agency loss in situation 2 is the distance between the agent's ideal policy and the principal's ideal policy. To see why, note that if the agent proposes $X = A$ and the principal accepts the agent's proposal, then agency loss is the negative of the difference between A and P. If the agent rejects this action, then agency loss is the negative of the difference between P and SQ. Since A is closer to P than SQ, by the definition of situation 2, then the principal is better off accepting the agent's action.

In situation 3, the principal's ideal policy is closer to the status quo than it is to the agent's ideal policy. This means that the principal would rather maintain the status quo than accept the agent's ideal policy. Since the agent knows this, he *will not* act to achieve his ideal policy. He will, however, choose another action. In equilibrium, the agent chooses the policy closest to his own ideal policy that the principal will accept.[2] The agency loss in situation 3 is at least as great or greater than the agency loss in any of the previous cases and is just less than the distance between SQ and P.

In situation 4, the principal and agent ideal policies are on opposite sides of the status quo (e.g. the principal wants higher taxes, the agent wants lower taxes). Here, no agent action is mutually agreeable to the principal and the agent. Therefore, the outcome is the status quo and the agency loss is the distance between SQ and P.

Comparing these situations to each other offers two insights. First, as we move from a lower numbered situation to a higher numbered situation, agency loss increases if it changes. Second, moving from lower numbered situations to higher numbered situations implies either an increase in the distance between A and P or an increase in the distance between P and SQ relative to the distance between A and P. Put another way, if the agent's ideal policy or the status quo moves away from the principal's ideal policy then agency loss can grow. That agency loss grows with the distance between P and A is straightforward—as the agent finds himself sharing fewer interests with the principal, he gains fewer rewards from serving the principal's interests. That agency loss can grow with the distance between P and SQ follows from the fact that a bad status quo makes a wider range of proposals attractive to the principal (i.e. beggars can't be choosers).

It is worth emphasizing that the Romer–Rosenthal model's predictions depend heavily on two simplifying assumptions. The first assumption is that the principal can only accept or reject the agent's action. If the principal is given greater powers relative to the agent (i.e. she can force the agent to take actions closer to P), then agency loss will decrease. Similarly, if the principal is given lesser power relative to the agent (i.e. she cannot reject agent actions), agency loss will increase.

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[2] If SQ is greater than A and P, then the agent will propose $P - |SQ - P| + \varepsilon$, where $\varepsilon > 0$ and small. If SQ is less than A and P, then the agent will propose $P + |SQ - P| - \varepsilon$.

The second simplifying assumption is that the principal and agent have complete information. For many acts of delegation, this assumption is wholly unrealistic. I now focus on what delegation accomplishes when information is incomplete. I define information as incomplete when a person is unable to predict the consequence of their actions with certainty. Within a delegation relationship, a principal, agent, or both can have incomplete information.

Principals and agents make use of two kinds of information.

- *Information about actions*: They want to know what the other has done.
- *Information about people and their context*. If people lack information about others' actions, they can often use information about a person (i.e. their skills or preferences) or their circumstances to deduce that person's actions.

If a principal or agent lacks either kind of information, the consequences of delegation can change dramatically. The extent to which the agent will attempt to act in accordance with the principal's preferences is particularly sensitive to whether or not principal and agent have asymmetric information. Information is asymmetric when one person knows more about the consequences of their actions than does the other.

As is customary in the literature on delegation, I will focus on the case where the principal knows less than the agent. While agents can lack information about their principals, students of democracy are far more concerned about the extent to which limited information hinders political principals' abilities to delegate successfully. Indeed, when principals do not know enough to track their agents' actions, the transfer of power inherent in an act of delegation can cause it to be equivalent to abdication— a concern that motivates much of the cited work on delegation. I adopt the same emphasis here.

When principals know less than agents, two kinds of problems arise: *moral hazard* and *adverse selection*. Rasmusen (1989: 133) describes these terms as follows:

- *Moral hazard with hidden actions*: Smith and Brown begin with symmetric information and agree to a contract, but then Smith takes an action unobserved by Brown...
- *Adverse selection*: [Smith knows things about himself that Brown does not.] Smith and Brown then agree to a contract. Information is incomplete.

The classic example of moral hazard comes from the realm of insurance. When a person buys a life insurance policy, he knows that his insurance company will pay for possible outcomes of risky behaviours. Since the insurer cannot prevent its clients from all risks, it faces a moral hazard problem—its clients may take riskier actions after a policy is issued. Moral hazard causes delegation problems when it gives the agent an opportunity to take actions of which the principal would not otherwise approve.

Adverse selection problems arise when an agent has *attributes* that a principal cannot observe. A classic example of adverse selection arises in the context of health insurance. As Kreps (1990: 626–7) notes: 'If premiums are set at actuarially fair rates for the population as a whole, insurance may be a bad deal for healthy people, who will then refuse to buy. Only the sick and dying will sign up. And premium rates must then be set to reflect this.' Also see Akerlof (1970) about similar properties in used car markets.

Adverse selection is a problem in many aspects of delegation—most notably elections. To see this problem, suppose that only two types of people choose to run for elective office—those who are truly public-spirited and those who line their own pockets with public resources. If candidates know their type and voters do not, the problem of adverse selection exists. If voters want only to elect public-spirited individuals, then all candidates have an incentive to portray themselves as public-spirited. The extent of agency loss for voters in this delegation will depend on the extent to which they can separate the dutiful from the knaves.

In what follows, I will first use a model to show how moral hazard affects delegation. Then, I will use similar logic to clarify the impact of adverse selection.

How Moral Hazard Affects Delegation

Lupia (1992) shows how moral hazard affects agency in the Romer–Rosenthal model. He finds that if the principal lacks information about the agent's action, then the agent never benefits from choosing any action other than his own ideal point. Such behaviour differs from that found in the Romer–Rosenthal model, particularly in situation 3.

In Romer and Rosenthal's situation 3, the agent proposes an alternative to the status quo that represents a compromise between himself and the principal. He offers the compromise because he knows that if he proposes his own ideal policy, the principal will reject it. In situation 3 with moral hazard added, the agent deals with a relatively ignorant principal and lacks any incentive to compromise.

The principal, in turn, reacts as if the agent can commit only to choosing his own ideal policy. Indeed, she bases her decision about whether to accept or reject the agent's action on her knowledge of the agent's ideal policy. If the expected utility from choosing the agent's ideal policy is greater than the utility from choosing the status quo, then the principal accepts the agent's action; otherwise she does not.

Table 2.2 displays the complete effect of moral hazard in tabular form (also see Lupia and McCubbins 2000). The left side of the table repeats Romer–Rosenthal's conclusions, while the rightmost two columns follow from Lupia (1992). The middle columns of the table show how moral hazard affects agency loss in the best possible case. In the best case, the principal guesses the agent's behaviour correctly despite her inability to observe his actions. The columns on the right display the effect of agency loss in the worst possible case. In the worst case, the principal's lack of information leads her to make mistakes—to reject agent actions that would benefit her and accept agent actions that hurt her. Within each set of columns, I show the policy outcome of delegation as well as its corresponding agency loss.

Table 2.2 shows that, in the worst case, the moral hazard increases agency loss significantly. In fact, situation 4's worst case scenario generates the greatest agency loss possible in the model (i.e. the agent takes actions that are bad for the principal that the principal then accepts). The rest of the table, however, reveals that moral hazard is not sufficient to cause agency loss. Indeed, if the principal can find a substitute for the information about agent actions that he lacks—enough information to make the best case scenario likely, then the impact of moral hazard can be reduced, if not eliminated entirely.

Table 2.2. *How Moral Hazard Potential Affects Agency Loss*

	Complete information: Romer–Rosenthal 1978		Incomplete information: Best case—Lupia 1992		Incomplete information: worst case—Lupia 1992	
	Outcome	Agency loss	Outcome	Δ Loss versus comp. info.	Outcome	Δ Loss versus comp. info.
Situation 1	P	None	P	0	SQ	$\|P - SQ\|$
Situation 2	A	$-\|A - P\|$	A	0	SQ	$\|A - SQ\|$
Situation 3	ε closer to P than SQ	$-\|SQ - P\| - \varepsilon$	SQ	ϵ	A	$\|A - (\|SQ - P\| + \varepsilon)\|$
Situation 4	SQ	$-\|SQ - P\|$	SQ	0	$A^{\star}$	$\|A^{\star} - SQ\|$

Notes: $A^{\star}$ denotes the agent's ideal point in the situation where he and the principal's ideal point are on opposite sides of SQ. In this situation, $A^{\star}$ is worse for the principal than SQ. ϵ denotes a number that is greater than zero, but very small. Note that $-\|X - P\|$ refers to the utility level of the principal given ideal policy, P, and delegation outcome, X. So, for example, when the outcome of delegation is the principal's ideal policy, as it is in the complete information version of situation 1, then the principal's utility is $-\|P - P\|$ or 0. When the outcome of delegation is the agent's ideal policy, as it is in several instances in the table, then the principal's utility is $-\|A - P\|$.

The main lesson, therefore, is that a principal lacking information about actions is not sufficient to cause agency loss. What matters more is whether or not the principal *can learn* enough to wield whatever power she may have over the agent effectively. In the following section, I explain when accountability mechanisms can, and cannot, provide such information.

How Adverse Selection Affects Delegation

Adverse selection entails a principal who lacks information about her agent's skills and preferences. Such information asymmetries matter because they correspond directly to the two reasons why an agent will fail to take actions that are consistent with his principals' interests.

- *The agent is unwilling*: An agent may be unwilling to pursue a principal's interests because she desires a different outcome. She may desire a different outcome because she and her principal have policy disagreement or because she and her agent disagree about how much of her own resources (i.e. time and effort) she should expend pursuing the principal's interests (see Brehm and Gates 1997).
- *The agent is unable*: An agent is unable to pursue a principal's interests because her resources are insufficient. Her ability will be a product of the complexity of the situation relative to her resources.

If an agent is willing but unable, she may want to satisfy the principal but cannot. If an agent is able but not willing, then she will choose not to work on the principal's behalf. To reduce agency loss, it is helpful for a principal to know if an agent is both willing and able. The theoretical study of adverse selection reveals how lacking either kind of information about an agent affects a principal's ability to delegate successfully.

To see the effects of adverse selection, it is helpful to refer back to Table 2.2 as a baseline. Now suppose that the otherwise fully informed principal in the Romer–Rosenthal model lacks information about the agent's willingness to accomplish the outcome she desires (i.e. she is uncertain about the location of A on the line [0, 1] in Fig. 2.2). Because the principal does not suffer from incomplete information about agent's actions (there is no moral hazard as in the Lupia model), the principal knows enough to accept actions that are better for her than the status quo and to reject those that are worse for her. Knowing this, the agent has no incentive to deviate from the actions he chose in the Romer–Rosenthal model. Therefore, *the outcome of delegation in this case is identical to the outcome in the Romer–Rosenthal model.*

If the principal lacks information about an agent's ability, by contrast, the outcome can differ. While the principal retains the ability to veto agent actions that are worse for her than the status quo, the agent's lack of information may lead him to choose different actions than was the case in the Romer–Rosenthal model and, therefore, Fig. 2.2. Indeed such an agent may choose an action that does not maximize his own utility—which would change the alternative to the status quo that the principal must consider. Depending on the nature of the agent's inability, the change in agent actions can either increase or decrease agency loss (i.e. the agent's mistakes about how to pursue his own self-interests may induce him to choose actions closer to or farther from P).

The outcome of delegation is less favourable for the principal when adverse selection and moral hazard appear together. To see why, refer back to the Lupia model (Table 2.2). Now suppose that in addition to lacking information about the agent's action, the principal also lacks information about his willingness to accomplish the outcome she desires (i.e. she is uncertain about the location of A on the line [0, 1]). In this case, the principal's best response is to base her decision regarding the agent's action on her beliefs about the location of A. If she believes that A is close to P (i.e. if she thinks it very likely that she and the agent want the same things), then she approves the agent's action. If her beliefs about the agent are correct, then the outcome of delegation resembles the best-case scenario in the Lupia model. If her beliefs are incorrect, however, then the outcome of delegation can be worse than Table 2.2's worst-case scenario. Specifically, a principal who faces adverse selection and moral hazard may approve actions with high agency loss and reject actions with low agency loss. To reduce agency loss in these cases, a principal must find some way to reduce her uncertainty about the agent's actions or the agent himself. In what follows, I describe conditions under which common political institutions can provide such information.

HOW INSTITUTIONS AFFECT AGENCY LOSS

Moral hazard and adverse selection give the principal an incentive to gather information about her agent. One means by which such information can be generated is institutions. Institutions affect incentives and can be constructed in ways that affect agent's incentives to reveal information about their motivations or actions. In the 1980s and 1990s, formal theorists spent considerable effort attempting to clarify what kinds of institutional designs can help delegation succeed. In this section, I highlight a few of these insights.

Formal theorists classify institutional designs that affect the provision of information to political principals as *ex ante* or *ex post* mechanisms.

- Principals use *ex ante* mechanisms to learn about their agents *before they act*, typically as they select particular individuals to serve as their agents. Such mechanisms are appropriate if a principal anticipates adverse selection problems.
- Principals use *ex post* mechanisms to learn about an agent's actions after the fact. Such mechanisms are a way to deal with moral hazard problems.

The most common forms of *ex ante* control are screening and selection rules. Screening and selection rules are devices that principals can use to sort good agents from bad before delegating to them. Such rules are an important part of the political institutions that govern many delegation relationships. Consider, for example, the extensive review process endured by candidates for cabinet ministries and, supreme courts and or Prime Ministerial candidates.

Contracts—task or time specific agreements between principals and agents—are also a common means for *ex ante* control. The point of such agreements is to establish shared interests between principals and agent, for example, by giving the agent a cut of any gain that the principal experiences as a result of the agent's efforts. It is common for contracts to specify an *ex post* mechanism of control (e.g. a clause such as 'If at date x, you have performed task y, I will reward you. Otherwise, I will sanction or sue you.').

In what follows, I survey models that reveal the conditions under which common *ex ante* control mechanisms such as those just described can help political principals reduce agency loss. I then discuss the effects of some *ex post* mechanisms.[3]

Ex Ante *Mechanisms: Screening*

A common screening mechanism in the context of delegation involves institutions that instigate competition between potential candidates for agent positions. A common supposition is that such competition always helps the principal choose her agents more effectively. The relationship between such screening practices and agency loss, however, is not so simple—as a comparison of three simple cases suggests.

Case 1: Romer–Rosenthal revisited   Refer back to Fig. 2.2 and to the Romer–Rosenthal model. Now suppose that we add additional agents to the model, remembering that it assumes complete information. Then, we can see that competition decreases agency loss. To see why, place the ideal policy of a second agent, say $A_2 \in [0, 1]$, anywhere on the line in any of situations 1–4. If A_2 is between P and A, then the effect of multiple agents is to move the outcome of delegation closer to P. That is, A_2 maximizes his utility by proposing an alternative to the status quo that is at least as close to P as is X,

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[3] Readers who are interested in a more comprehensive theoretical treatment of how information and institutions affect choices such as those inherent in delegation can consult introductory texts such as McMillan (1992: parts II and III), intermediate texts such as Kreps (1990: chs 16 and 17) and Salanié (1998), advanced texts such as Laffont and Tirole (1993), or seminal articles such as Crawford and Sobel (1982), Milgrom and Roberts (1986), Farrell and Gibbons (1989), Banks (1991), Farrell and Rabin (1996).

the alternative that the first agent proposed when lacking competition. If A_2 is not between P and A, then adding A_2 has no effect. Therefore, in the complete information setting of the Romer–Rosenthal model, setting up a competition between agents can reduce agency loss.

Case 2: Competition Sometimes Fails   Competition need not have the same effect when the principal faces information problems. To see why, consider the analogy of the government putting up for auction the right to be an agent. Such a selection procedure occurs when a government hires a private firm to perform a public service (e.g. municipal construction projects). One could also use an auction analogy to characterize the battles for cabinet positions that occur during coalition formation negotiations.

When a principal forces potential agents to compete for the right to be her agent, she can induce the potential agents to reveal information about themselves—in particular their ability and willingness to perform the tasks she asks of them. The conditions under which such a competition best reduces agency loss are as follows:

- it is easy to determine whether or not the agent can perform the task in question,
- potential agents know whether or not they are willing and able to perform the task in question,
- potential agents know whether or not other potential agents are willing and able to perform the task in question,
- it is relatively easy and costless for the principal to punish the agent for failing to accomplish the task *ex post*.

If all of these conditions are met, then potential agents have an incentive to truthfully report their willingness and ability to serve the principal. In equilibrium, the most efficient potential agent becomes the actual agent. This outcome occurs because it solves the adverse selection problem. In this case, no agent has an incentive to make a false claim about his attributes (in the form of his bid) just to win the auction. In this situation, auctioning the right to be an agent minimizes agency loss.

If, however, any of these conditions are not met, then competition need not have such a pleasant effect. For example, if the principal cannot easily determine whether the agent has done what he promised to do, then the moral hazard problem reappears. Alternatively, if potential agents are uncertain about their own ability or their competitors' abilities, then they may gain an incentive to understate or overstate their own desire for the job. Such an outcome can lead to increased agency loss.

Case 3: The Hold-Up Problem   Moreover, if the principal lacks information about the agent's abilities and cannot punish the agent, then the principal is exposed to an extreme form of moral hazard known as the 'hold up' problem (e.g. see Williamson (1989) and Salanié (1998: ch. 7)). In a 'hold up' problem, a question arises about who will obtain the benefits from resources already committed to a particular activity.

To see how a hold up problem works, suppose that when a principal selects a particular person to be her agent, that agent then acquires valuable expertise that those who were not selected to be the agent cannot acquire. This agent can then use his expertise as leverage to renegotiate the terms of his relationship with the principal and

extract additional benefits for himself. Consider, for example, a person who becomes identified with excellent service in a particular cabinet post. Upon achieving such a status, the 'excellent' minister may seek increased power in a wider range of government decisions. As the government's effectiveness or public standing becomes increasingly dependent on the 'excellent' minister's performance, they may have a greater incentive to let this agent have his way—even if it increases agency loss.

At this point, any reduction in agency loss that may have resulted from earlier competition may be lost. In sum, while competition among agents may seem like a natural solution to adverse selection and moral hazard problems, the benefits of competition are realized only if certain informational and institutional conditions are met.

Additional Caveats

Several additional factors work against competition among agents as a means of increasing accountability and decreasing agency loss. First, competition can preclude the most qualified potential agents from seeking the job. For if the skills required to be an effective agent differ from the skills required to win the competition (as is sometimes alleged in mass elections) or if the most skilled candidates for a position lack the resources needed to prevail in competition for a job (as may be the case with qualified experts in a field who lack political connections or the field of candidates who choose to run for the US presidency), then competition may produce a suboptimal outcome (also see Aghion and Tirole 1997 for a more general discussion of participation constraints). Second, competition among agents can entail negative externalities. In the rush to provide a particular service, for example, competition may cause efforts to be duplicated and lead to inefficiency. Such caveats are not meant to imply that competition is the wrong way to seek accountability or reduce agency loss. However, focusing on these caveats reminds us that means such as competition do not automatically produce desired ends (see Salanié 1998 for a recent and more technical review).

Ex Ante *Mechanisms: Selection*

By selection, I mean to describe cases where one person (e.g. an agent) chooses an action that reveals to other players (e.g. a principal) a previously hidden personal characteristic. By taking a firm public stand on a controversial issue, for example, a member of parliament may reveal to others the depth of his or her concern about the issue. By doing so, the MP 'selects' a public identity that may reveal previously unknown characteristics. Such selection mechanisms can help principals to learn about their agents and delegate successfully.

Economic *signaling models* are efficient means for understanding the general properties of selection mechanisms. The seminal signaling model (Spence 1974) focuses on the plight of an employer who needs to hire a new worker. While the employer prefers to hire a skilled applicant, she cannot initially observe an applicant's skill level. However, she knows that skilled applicants can obtain a tangible good—formal education—with less effort than can unskilled applicants (i.e. unskilled applicants are more likely to drop out of school before obtaining a degree). The question Spence

poses is: If the employer can observe whether a particular applicant obtained an education and bases her hiring decision on the applicant's education, will she hire high-skilled applicants?

The model's conclusion is that the diploma convinces the employer of the applicant's skill level only if unobservable skill levels and observable education levels are highly correlated. Such logic clarifies important aspects of political interactions—it reveals that factors such as the agent's reputation for taking particular actions persuade the principal of the agent's skill level only if unobservable skill levels and observable reputations are sufficiently correlated. For example, if a background in economics correlates with ability to be an effective finance minister, then governments that want an effective finance minister have an incentive to give more serious consideration to ministerial candidates with an economics backgrounds.

Ex Ante *Mechanisms: Contract Design*

Laffont and Tirole (1993) are among a group of economists whose work on contracts clarifies an analogous means of *ex ante* agent selection. They show how offering potential agents a 'menu of contracts' can induce agents to reveal things about themselves that then help the principal limit the extent of agency loss. While their work is multifaceted, I paraphrase the basic insight of their efforts as follows. When structuring an agent's incentives, *ex ante*, a principal faces a trade-off between risk-sharing—which prevents the agent's rewards from depending too strongly on observable outcomes—and incentives— which induce the principal to condition the agent's rewards on observable outcomes.

The concept of risk-sharing is important when the principal asks the agent to perform tasks about which the agent is not completely informed. For example, certain military exercises may be required to satisfy a critical domestic agenda. In this case, the military is the agent of principals in the government. Suppose, however, that the outcome of a military operation is often uncertain *ex ante* and that there is a national interest in having the military take certain risks. A military officer's incentive to take such risks will then be conditioned on how the government treats him in the event that things go wrong. If the government cannot credibly commit to take some responsibility for bad outcomes (e.g. casualties of battle), then military officers have less of an incentive to take risky actions, even if the rewards of such an action—if successful— would be great for everyone.

In such a case, the polity may benefit by the government committing to share some of the military's risk. But they can go too far. If, for example, the government commits to assume all of the risk—by holding itself and not the military fully responsible for military actions—then the military has an incentive to take potentially beneficial actions. However, accountability then wanes.

While many of the problems of delegation may seem easily solved by forcing agents to assume the consequences of every outcome with which they are involved, this appearance is illusory. For if observable outcomes depend on some factors that are outside of an agent's control, then tying the agent's fate to outcomes can dissuade the agent from performing valuable services—and can actually increase agency loss.

Ex Post *Mechanisms*

In many democratic delegations, a principal may lack the information she needs to distinguish agent actions that help her from agent actions that hurt her (i.e. she may lack knowledge sufficient to reduce agency loss).[4] Such principals have three ways to gain information about her agent's actions: direct monitoring, attending to the *what the agent says* about his activities, or attending to *third party testimony* about agent actions.

Relying on others for information can be advantageous because it requires less of the principal's time and effort than does conducting her own investigation. Such dependence, however, can also entail substantial peril. Not all people from whom principals can seek advice are trustworthy or knowledgeable. Therefore, a principal who wants to exert some degree of control over her agent's actions must be very selective about which advice she follows. She has an incentive to seek information providers who provide credible reports of agent activities and to avoid information providers who provide vague or misleading reports.

Some procedural requirements, for example, attempt to induce interested third parties to share information with the principal that the principal might not otherwise receive, as is the case when government officials hold public hearings on agency actions and invite affected interests to provide reports or give testimony. McCubbins and Schwartz (1984) call this process 'fire alarm oversight' because of its similarity to concerned citizens pulling fire alarms to alert firefighters about dangerous activities. Such processes allow interested individuals to 'signal' political principals about what an agent is doing. It is useful to note McCubbins and Schwartz contrast fire alarm oversight with 'police patrol oversight' in which principals do much of the oversight themselves.

If a principal can achieve the same quality of oversight using fire alarms and police patrols, fire alarm oversight would be preferred because others pay the cost of learning about the agent's activities. The institutional context in which fire alarm oversight is attempted can have a great effect on a principal's ability to learn about her agent's activities. Fire alarm oversight is most effective when it occurs amongst institutions that feature a means for assessing the information provider's credibility. Institutions can affect what people *choose* to say and what people *choose* to believe. When they have this effect on people who signal principals, they affect the principals' ability to judge the credibility of others.

To clarify how institutions affect delegation, I describe the results of a model (Lupia and McCubbins 1998) that includes the potential for moral hazard described in Lupia (1992), and adds a third party who can send signals to the principal about what the agent is doing.

In the model, principals may be uncertain about the quality of the third party's advice. Specifically, Lupia and McCubbins assume that principals may be uncertain about how much these advice givers know about the agent's actions and about whether or not the third party is attempting to mislead the principal. They further assume that

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[4] The following argument draws extensively from a parallel one in Lupia and McCubbins (2000).

signals are sent in the context of institutional forces including the threat of verification (i.e. a device that helps the principal distinguish true claims from false claims). Such threats can affect what people *choose* to say and what people *choose* to believe. When institutions have this effect on people who signal principals, they affect the principals' ability to judge the credibility of others.

Institutions increase the likelihood of verification when they provide new actors with incentives to provide information about an agent's actions. An institution such as the European Union (EU), for example, can now provide information about domestic level activities (see Lupia 2000). A domestic agent who, absent the threat of verification, will pursue a personal agenda, rather than the agenda of his principal (in his own country), must now consider the potentially verifying activities of actors in other EU nations. When EU membership increases the population of potential verifiers, domestic agents are faced with a higher likelihood that their principals will detect and reject his actions. In such a case, the emergence of the European Union can reduce agency loss domestically.

Using the model described earlier, Lupia and McCubbins (1998, paraphrased) generate the following result about when the principal can use signals to overcome moral hazard problems with her agent:

Proposition 1.   *The principal can distinguish agent actions that are better for her than the SQ from those that are worse only if:*

- *the principal's prior knowledge is sufficient for this task or*
- *she can correctly perceive a third party to have common interests and the knowledge she desires or*
- *institutional factors, such as verification, provide effective substitutes for her lack of knowledge about the third party's knowledge and interests.*

This proposition implies that the principal need not know very much about what her agent is doing in order to delegate successfully. Indeed, if institutional forces are sufficient to induce the principal to follow the third party's advice, then delegation can succeed even if the principal initially lacks knowledge about her agent, and even if she believes that any third party from which she could learn has conflicting interests.

Put another way, if a principal has access to reliable advisers then she need not be very knowledgeable about her agent to act as if she was so knowledgeable. Moreover, in cases where a principal may lack information about those who attempt to advise her, institutions can substitute for the type of information she lacks. Consider, for example, the position of someone—a juror or a judge—who must render a verdict in a trial. There will be cases when the juror is presented with a witness whose motives or knowledge she cannot verify on her own. However, if the principal is in a setting where factors such as a high likelihood of verification are present (e.g. when a valuable reputation is at stake and cross-examination is likely), then she need know little about the witness's interests to make a reliable credibility assessment. The incentives imposed on the witness by the institutional context in which she testifies may be sufficient for the principal to render an accurate judgement about the witness's credibility.

Another common form of *ex post* accountability mechanism is what Kiewiet and McCubbins (1991: 34) call 'institutional checks'. Such checks are means by which principals

can reduce agency loss by increasing the likelihood of verification for those who provide information about agent actions as Kiewiet and McCubbins attest: 'Rather than striving for an unbiased source of information, a principal may do better obtaining biased reports from different agents who have conflicting incentives. The view that legal proceedings should be adversarial rather than administrative is based on the same logic. Conversely, checks are disabled when agents' incentives cease to be in conflict.'

When it is possible to construct such checks, many problems caused by the principal's lack of direct information about an agent's activities can be alleviated. However, like contracts, institutional checks are not always feasible or effective. As was the case with contract design, if such checks prevent agents or information providers from undertaking risky but potentially beneficial activities, then agents and third parties will avoid such actions, which may lead to increased agency loss *ex post*.

CONCLUSION AND IMPLICATIONS

It is impossible to provide a simple statement that describes how common accountability mechanisms affect delegation and its perils. However, reviewing the insights of this chapter can clarify when delegation is capable of accomplishing particular things.

- When a principal and agent desire precisely the same policy outcome and the agent is willing and able to put forth the work needed to achieve the objective, then delegation succeeds and there is no agency loss.
- As the agent's willingness or ability to serve the principal decreases, then the possibility for agency loss arises.
- When an agent is not fully willing or able to serve the principal, the principal can minimize agency loss if she has complete information about the agent's actions.
- If the principal lacks such information, then her ability to reduce agency loss depends on her ability to acquire other kinds of information.
- Through *ex ante* mechanisms, principals can attempt to learn about important agent attributes such as their policy motivations, the extent to which they are willing to exert effort on the principal's behalf, and their ability. With such information in hand principals can reduce agency loss. In many cases, however, such mechanisms are impossible to construct (i.e. sometimes it is impossible to learn what you need to know about an agent in advance) and *ex ante* strategies will be less effective.
- Through *ex post* mechanisms, principals can attempt to learn about agent actions from others. With such information to hand, principals can effectively distinguish agent actions that benefit them from actions that do not—a skill that allows them to reduce agency loss. Institutions can help by clarifying for principals whose reports of agent actions are credible.

Political principals delegate with the hope that their agents will work towards ends they desire. While delegation can have this effect, it need not always. In cases where agents are willing and able to serve their principals, delegation increases those principals' abilities to accomplish their goals. Otherwise, the perils of delegation arise. Given the many demands on voters, members of parliament, and members of government,

it is unrealistic to expect them to have detailed information about their agents' preferences or actions. The perils commonly associated with such information asymmetries, however, are not inevitable. *Ex ante* and *ex post* accountability mechanisms can be made part of a country's political institutions—and those entrusted with the responsibility of governing can retain control of what is done in the government's name.

I conclude this chapter by describing what such insights imply about delegation chains. As we look across the parliamentary democracies of Western Europe, we see within it delegation chains of many shapes. While these chains differ in important ways, it is important to recognize that the links in these chains are all constructed from the same basic material—principal–agent relationships that are affected by information and institutions in systematic ways.

To see the effect of this insight on delegation chains, I begin with a simple example. Suppose, for a moment, that a country's chain of delegation is a straight line—one link connects voters to MPs, one link connects MPs to governments, and so on. In such a chain, a broken link implies a broken chain. So, for citizens at one end of the chain to hold accountable civil servants at the other end, every link of the chain must be strong. Reducing agency loss in such cases requires that the necessary conditions for successful delegation are satisfied at every link in the chain.

If this condition is not satisfied, the chain is broken. As a result, principals on one side of the break have no direct control over agent actions on the other side of the break. The agents on the other side may, if such principals are lucky, take actions that are good for the principal with the result being a minimum of agency loss. This happy outcome is not accountability as defined above because the principal has no direct control.

What would it take to satisfy this condition? Not as much as a follower of Weber might think. Citizens at one end of a straight chain holding accountable civil servants at the other end does not, for example, require that every principal have complete information about the actions of their agents. Instead, if at each link in such a chain of delegation, *any* of the conditions in Proposition 1 hold, principals have control over their agents—and agency loss can be no worse than if the principals had never delegated. If, moreover, a policy exists that both the principal and agent prefer to the status quo (as is the case in situations 1–3 in Fig. 2.2 and Table 2.2) at every stage in the chain, then delegation will make all principals better off than if they had not delegated.

But what happens if a country's delegations are not linked in a serial fashion? The answer depends on whether failed delegation at one link in the chain can be remedied by actions at a later link. If so, then it is easier to reduce agency loss—the conditions for successful delegation must be satisfied at only one of the two substitutable links. Consider, for example, cases where a policy-maker has the option of working with any of several bureaucratic agencies to perform a particular task. If the policy-maker cannot delegate successfully to agency A, delegation may nevertheless succeed if he can delegate the task to an agency B. If the strength of the delegation chain depends on this policy-maker's ability to delegate successfully, he need only find one reliable agent to keep the chain strong.

As important as the width of the chain is its length. In many cases, the longer the chain, the greater the likelihood of agency loss. Consider, for example, a government's

attempt to affect what teachers say to children. In this case, the chain of delegation extends from the government to cabinet ministers to high-level civil servants in the nation's capital to possibly many additional stages all the way until a directive arrives in a classroom itself. If a teacher simply ignores the mandate, then delegation fails. Indeed, for certain policies, it may be necessary that *all* agents in the chain approve of the change. When such a requirement holds, the length of the chain becomes increasingly relevant as more links entails more people who have a veto, and greater difficulty for voters or MPs who want agents to 'feel a tug' when they pull the chain.

The chapters that follow give empirical flesh to this theoretical backbone. When these kinds of knowledge are combined, thy should increase the extent to which students and real-world observers understand the most effective and efficient ways to delegate. If they do, then volumes such as this will continue to give governments large and small ability to delegate successfully—a product of great value in an increasingly complex world.

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