Discovering the Dark Side of Power: The Principal's Moral Hazard in Political-Bureaucratic Relations

Marian Döhler

To cite this article: Marian Döhler (2018) Discovering the Dark Side of Power: The Principal's Moral Hazard in Political-Bureaucratic Relations, International Journal of Public Administration, 41:3, 190-202, DOI: 10.1080/01900692.2016.1256893

To link to this article: https://doi.org/10.1080/01900692.2016.1256893

Published online: 16 Dec 2016.

Submit your article to this journal

Article views: 130

View related articles

View Crossmark data
Discovering the Dark Side of Power: The Principal’s Moral Hazard in Political-Bureaucratic Relations

Marian Döhler
Faculty of Humanities, Institute of Political Science, Leibniz University Hannover, Hannover, Germany

ABSTRACT
Principal agent (PA) is among the most prominent concepts for analyzing the relationship between politics and bureaucracy. Nonetheless, the inherent bias of PA scholars to attribute moral hazard almost exclusively to the agent, usually referred to as “bureaucratic drift,” requires re-examination. Building on the sparse literature in which moral hazard of the principal is considered, this paper provides empirical evidence for a neglected aspect of the PA concept. Three cases of German regulatory agencies responsible for drug control, financial services and rail safety are analyzed in critical situations which were largely perceived as bureaucratic failures. The analysis reveals that a good deal of these failures, ranging from negligence to suppressing crucial information, has to be attributed to the political principal. This is called the dark side of power because the intention is to shift blame or to dodge political responsibility. Turning conventional PA reasoning upside down, the conclusion is that the principal’s moral hazard should be considered more routinely as a potential explanation for political-bureaucratic interactions.

Introduction: Is the principal always right?

Since the principal-agent (PA) framework diffused into political science roughly three decades ago, it was applied to a wide range of subjects such as international relations, electoral accountability, and European politics (Alter, 2008; Menz, 2015; Strom, Müller, & Bergmann, 2003). But, political-bureaucratic relations became the field in which PA flourished most. Due to the similarities between the PA concept and the real world of political-bureaucratic relations’ fundamental questions of delegating functions to agencies, proper institutional choice and controlling bureaucracies, the canonical PA concept fits almost like a glove to the study of political-bureaucratic relations. The guiding assumptions, developed in economics (Pratt & Zeckhauser, 1985), revolve around the interaction between two parties: a principal who hires an agent to perform functions the principal is unable to conduct himself. Inside an agency relationship, an information asymmetry is assumed which the agent is willing to exploit at the expense of the principal. This problem is exacerbated because the principal is exposed to hidden action by the agent, who, as a consequence, is allured to moral hazard (Holmstrom, 1979). The principal will therefore try to minimize “bureaucratic drift,” as it is called in political science. In economics, incentives, often as part of a contract, are regarded as a solution (cf. Sappington, 1991).

Whereas economists are fairly optimistic that agency loss can be minimized, political scientists regularly presume a “conflict of interests” (McCubbins, 1999, p. 32), due to diverging preferences. Rather unsurprisingly, in political science rendering a task to a bureaucratic agent is considered to be a “delegation dilemma” (McCubbins, 1999, p. 30; McCubbins, Noll, & Weingast, 1998; Sobol, 2015). Given the central role the goals of the principal play in the model, it has been difficult for researchers to relax the assumption that the principal’s preferences are invariably justified (Carpenter & Krause, 2015). Moral hazard by the principal thus appears as an anomaly or even as an imposibility that does not suit the canonical PA version: “The phrase ‘principal’s moral hazard’ makes no sense, since the principal’s proclivity to follow her own interests is presumed to be natural and legitimate” (Miller, 2005a, p. 220). Political scientists focusing on the causes and consequences of delegation typically assume away the principal’s moral hazard. Even if PA relations are discussed in an accountability context, accountability duties are unilaterally directed at the agent (Gailmard, 2014).

At first sight, there seems to be little room to counter these predispositions because politicians are legitimized to impose their preferences on bureaucratic agents via general...
elections. Given the inevitable bureaucratic expertise, it also seems to be plausible that bureaucrats tend to exploit information asymmetries to pursue their preferences. However, assuming that politicians are much more driven by short-term incentives than bureaucrats, preferences may diverge not because the agent is shirking, but because the political principal moves away from the original policy agreement (cf. Waterman & Meier, 1998). Additionally, if “the overall efficiency” (Miller, 2005a, p. 220) is the yardstick, i.e. taking into account the effects of the principal’s behavior outside the PA relationship, behavioral incentives become visible which are not considered in the canonical PA-concept. Politicians might be, and often are, tempted to breach electoral promises or to shift the blame for failures and unpopular policy results to the bureaucratic agent. Despite these objections the “antiagency bias” (Sobol, 2015, p. 4) has largely prevented PA research from giving the principal’s moral hazard a greater role, if any. Thus far, the principal’s moral hazard has mostly been mentioned in passing and hardly any attempts have been made to identify the conditions under which the principal’s moral hazard is likely to occur.1 This is the precise aim of the subsequent analysis which proceeds as follows: In a first step, the literature is evaluated in order to identify factors which are likely to trigger the principal’s moral hazard. Second, using three case studies from German regulation policy, the presence and intensity of these factors are examined over time. The findings are, finally, condensed into an analytical framework which is presented as an extension of the PA concept.

**From simple to more elaborate principal-agent models**

An early attempt to rethink the canonical PA-Model refers to role-conflicts of the principal. Whereas the simple model assumes a dyadic relationship between principal and agent, Harrison White (1985) and others found that the role of the principal can be reversed if the chain of delegation is extended. Perrow used a merger between two firms to criticize the assumption that only the agent behaves opportunistically (Perrow, 1986). In this case the principal of firm A is transformed into the agent of his new superiors in the merged firm B, while retaining the role of the principal vis-à-vis his subordinates. In this sandwich position the principal-turned-agent may exploit his superior knowledge in relation to his new principal. Moving into a similar direction, Carr and Brower stress the multiple motivations of the principal. By focusing on different levels of hierarchy inside government agencies, the authors show that “the midsection of the organization” (Carr & Brower, 2000, p. 131), in which employees are sandwiched between superiors and subordinates, is a likely location for opportunistic behavior. Both role-conflicts and multiple motivations can be traced back to a modified chain of delegation. In politics, this can easily happen by waking up “sleeping” or implicit principals. Whenever the media, interest groups or voters sense irregularities related to a government agency they may hold the political principal liable. This typically starts a blame game, which the principal would not have engaged in otherwise.

Multiple principals have been discussed already in economic PA applications, but gained special importance in the political, especially the legislative context. This reflects the heterogeneous structure of American congress to which the bulk of PA research was applied (Miller, 2005a; Wood, 2010). Multiple principals seem to be less relevant in parliamentary systems with a sequential order of political authority. A parliamentary majority competing with their own minister about agency policies is unlikely, if not entirely precluded. But, even with the minister as the dominant political principal, single MPs may occasionally behave like principals, either by pressuring the minister, or by evoking outside stakeholders such as affected industries or the media. More generally, the widespread existence of implicit delegation in politics supports the mobilization of multiple principals of sorts.

The ubiquitous notion of bureaucratic drift has been complemented by “coalitional drift” for some time, defined as the trade-off between the effort of “an enacting coalition” (Shepsle & Bonshek, 1997, p. 363) to insulate a bureaucratic agent from future legislative interventions and the side-effects of doing so. Granting autonomy to an agent can serve the purpose of insulation, but “comes at the price of an increased potential for bureaucratic drift” (Shepsle & Bonshek, 1997, p. 375). As long as the notion of coalitional drift is telescoped through the lens of the enacting coalition, trying to make a deal struck, it misses an important element of political-bureaucratic relations. Without undue conceptual stretching, coalitional drift may also stand for “drifting principals” (Schillemans & Busuoiu, 2014, p. 192). This perspective, by contrast, runs counter to the conventional PA logic, because shirking by the principal becomes part of the feasible set. This is less relevant if coalitional drift is based on general elections. But, if changing economic conditions, new policy ideas or partisan opportunism leads to coalitional drift, the principal, trying to justify a new policy outside of the legitimacy generating legislative process, may be enticed to reverse the original PA contract.

Whereas coalitional drift works over time, a growing literature refers to cases in which the principal lets the agent run into trouble from the outset, willfully, or both. An

---

1 Sobol (2015) and Miller (2000, 2005a, 2005b) are rare exceptions.
example is taken from Russian domestic policy during the transition era, when president Yeltsin repeatedly treated the government as “a detachable policy arm” (Sokolowski, 2001, p. 551) to distance himself from unpopular policies he had ordered in the first place. Building on the international relations and Europeanist literature, Sobol recently found evidence for what he calls “pathological delegation.” This covers deficiencies, ranging from the well-known “conflicting, unclear or unrealistic objectives set by the principal” (Sobol, 2015, p. 12) to the more radical “perverse incentives for the principals to behave in ways inimical to the delegation act thus hinder the agent’s work” (Sobol, 2015, p. 5). Even beyond shipwrecking an agent on purpose, the underlying logic is consistent with the bulk of implementation research which has shown that policy problems, unresolved during the legislative process, are frequently relocated to the bureaucratic agent, who in turn is blamed for misconduct.

A possible source for deficient delegation is the “contractual opacity” (Lane, 2005, p. 56) in politics, the consequences of which are conceivable when looking at a distinction introduced by Waterman and Meier (1998, p. 175). The first PA type, dominating in the private sector, is called the economic model. If a sloppy monitoring of the agent results in higher costs, the principal is unable to pass them on to someone else. By contrast, in the institutional model, which is an equivalent for politics, the principal is often able to shift the cost of a deficient contract or sloppy monitoring to the tax-payer. Typical examples are military procurements or public buildings with exploding costs. Even if the principal has to fear the indirect cost of electoral punishment, the distinction between the economic and the institutional model can explain why PA-relations in the private sector tend to be crafted more rigorously than in politics. It is the institutionalized risk cushioning that provides political principals with manifold opportunities to pass on the costs to the taxpayer and the blame for failures to bureaucratic agents.

This is augmented in parliamentary systems like Germany, in which each agency belongs to the area of responsibility of a federal ministry. The necessary complement to ministerial responsibility is the hierarchical oversight that creates an institutionalized opportunity for hidden action by the principal (Döhler, 2007; 2011). German ministries can reverse every single decision taken by subordinated agencies or instruct them in advance without appearing as originator of a policy. Hierarchical PA relations, nonetheless, cannot bypass the problem of monitoring costs. Because monitoring is hardly something for which political credit can be claimed (Wood, 2010; Döhler, 2011), political principals will hesitate to invest much effort. This might unfold into a problem of deficient allocation of resources or attention. The institutionalized option for hidden action then creates incentives for the political principal to shift the blame downwards whenever this provides relieve from being held responsible.

This list of modifications of the canonical PA concept is far from being exhaustive, but already hints to the conditions under which the principal’s moral hazard is likely to emerge. Two categories can be distinguished. First, context-related factors are mostly stable institutional conditions under which politicians and bureaucrats operate. Context-related factors are not causing moral hazard, but create opportunities to do so. Second, there are situation-related factors which trigger a particular course of action either resulting from long-term economic or political changes or from short-term shifts or crises. Table 1 summarizes the driving forces enabling the principal’s moral hazard, which will be traced in the following empirical analysis.

Crises represent the only outlier which is not derived from the PA concept. This situation-related factor serves a dual purpose in the present analysis. First, critical situations signal the rare opportunity for observable, press-documented political-bureaucratic interactions which otherwise would remain invisible. Second, they serve as a focusing event, in which the principal is exposed to political costs, ranging from reputational loss to enforced resignation. Although crises can be regarded as an independent variable in its own right, its effect will presumably rise if other situation-related factors are present simultaneously. Deficient delegation may work from the outset, for example when the workload for a newly created agency is mis-calculated. Alternatively, the consequences may surface later during the implementation process.

### Political-bureaucratic relations in a principal-agent perspective

The subsequent analysis is based on three most likely cases in which critical situations can be expected to motivate moral hazard by the principal. This is not pretending that

| Table 1. Factors determining the opportunities for moral hazard of the principal. |
|---------------------------------|---------------------------------|
| Context-related factors          | Situation-related factors       |
| Multiple principals (ministry, parliament, media, voters) | Crisis situations (self-inflicted or third-party caused) |
| Monitoring costs (limited oversight resources) | Coalitional drift (new government, economic ups and downs, changing policy ideas, industry pressures) |
| Ministerial responsibility (hierarchical oversight) | Chain of delegation (PA relationship extended or shortened) |
| Institutionalized risk cushioning (hidden action, tax-financed bail-out) | Deficient delegation (goal conflicts, regulatory gaps) |
the cases under review are typical. They are deviant in the sense that crises of different magnitude have prompted politicians, either responsible ministers or members of parliament, to announce severe reform plans for each agency. The “relative devianness” (Seawright & Gerring, 2008, p. 302) is difficult to determine because the basic population of similar cases is unknown. Despite functional differences between the three regulatory arenas, the common denominator is the contingency for huge political costs. Drug regulation and rail safety deal with human lives, whereas deficient financial regulation might shipwreck every government’s budget.

**Drug regulation: A principal on the run**

Political-bureaucratic relations in German drug regulation are a typical example of a case where the factors leading to moral hazard do not occur in a distinctive sequence but rather randomly. When the first “modern” drug law in Germany came into effect in 1978, the Federal Health Office (Bundesgesundheitsamt—BGA), responsible for drug authorization and post-market surveillance, immediately caught the crossfire of contradictory criticisms. Whereas industry representatives complained about an overstretching of regulatory requirements, consumer advocates condemned the BGA for not being strict enough (Hohgräwe, 1991; Döhler, 2007). The drug law itself, laced with paragraphs open to judicial and scientific interpretation, reflected the goal conflict between consumer protection and industry policy. A seminal problem was the insufficient capacity of the agency which had to face not only a mountain of old cases waiting for authorization, but also an unexpected rise of applications for new drugs, both of which contributed to long-lasting authorization “jams.”

The efforts by the BMG to handle this deficient delegation stood in contrast with the lack of reactions by the responsible Ministry of Health (Bundesministerium für Gesundheit—BMG). BMG officials were accustomed to look upon the mostly research-based BGA institutes as a source for scientific advice. Overstrained and, to certain extent, unwilling to support the BGA in controversies surrounding the implementation of the drug law, the ministry directed most of its efforts at dodging responsibility whenever the agency would run into trouble (Hohgräwe, 1991; Döhler, 2007). Ministerial bureaucrats handled their oversight responsibility on a mercurial case by case basis and shied away from ambitious problem-solving, even though the press increasingly exploited the BGA’s looser image. The “lame duck policy” (Kenis, 2001, p. 505) of a demoralized agency leadership was tacitly accepted by the ministry and finally paved the way for dismantling the BGA.

In autumn 1993, the public was shocked by press reports raising the suspicion that hundreds of patients had been infected by HIV-contaminated blood transfusions (Conrads, 2004). It turned out that the BGA had failed to forward earlier information to the Ministry (Kenis, 2001). Since the BMG itself had repeatedly issued statements, based on BGA information, confirming that blood transfusion and blood-based drugs had undergone a reliable process of inactivating viruses, the Minister himself came under pressure. In a coup, unprecedented in German post-war history, he decided to split-up the BGA into three separate agencies in October 1993. This was advertised as holding an institution responsible that became ungovernable. In fact, a parliamentary inquiry revealed that BGA officials either ignored or underestimated the risk related to blood products, but at the same time they also criticized the Ministry for ignoring warnings by scientists, for outright negligence by previous ministers, and for a deficient flow of information inside the Ministry (Bundestag, 1994). All these findings could have forced the Minister to resign. But the spectacular dismantling of an agency, which had lost political as well as public support, worked well enough to diffuse political and media pressure.

Since 1994, the Federal Institute for Drugs and Medical Devices (Bundesinstitut für Arzneimittel und Medizinprodukte—BfArM) has been responsible for drug regulation. The creation of the European Medicines Agency (EMA) in 1995 initially absorbed much attention, putting the BfArM out the political spotlight for much of the late 1990s. Even the relocation from Berlin to Bonn, which severely hampered the BfArM’s performance due to the loss of qualified personnel, took place largely unnoticed.² A new round of political row started in 2001, when the red-green coalition, elected in 1998, was alarmed by complaints about the duration of drug authorization which, according to an industry-commissioned report, was twice as long as the European average (Boston Consulting Group, 2001). Especially Social Democrats, who had taken over the Ministry of Health, were eager to refute accusations of being hostile to industry. Even though the agency made progress in reducing pending authorizations, the complaints were not entirely unfounded. As an evaluation report of the Science Council confirmed, the time-limit for authorizing new drugs was constantly exceeded. The BfArM, not yet fully recovered from the Berlin-Bonn move, still struggled with leftover cases which absorbed crucial capacities (Döhler, 2007).

²The relocation was long scheduled to compensate the former capital Bonn for losing the seat of government.
This well-known problem was framed into a new context by the pharmaceutical industry which echoed the European Commission’s approach that both drug authorization and post-market surveillance should contribute to international competitiveness. German politicians rapidly adopted the coalitional drift. The findings of a task force, set up by the Ministry in 2003 to respond to the BGC report were leaked in early 2004. This might easily have backfired and turned the performance problem of a federal agency into a question of ministerial responsibility. The subsequent blame game, however, prevented then Minister Ulla Schmidt from being linked with decades of deficient delegation, which manifested itself especially in ignoring visible problems of drug law implementation (Ernst, 2006, p. 19). In an activist move, politicians across partisan boundaries demanded a complete overhaul of the BfArM. The quiet dismissal of the BfArM president in spring 2004 was followed by the publication of the task force report, which was presented by the ministry like a discovery, even though the list of “deficiencies’ could have been written down by every insider at one go” (Dienst für Gesellschaftspolitik, 2004, p. 6). The newly appointed president was charged with an internal reorganization (which was already underway), escorted by a government-sponsored bill in mid-2005, intended to transform the BfArM into a German Pharmaceutical Agency (Deutsche Arzneimittel- und Medizinprodukteagentur—DAMA) with an autonomous legal status, a business-like leadership structure and entirely financed via authorization fees.

The bill contained several elements, efficiently camouflaged by the new public management rhetoric, to diffuse ministerial responsibility for an agency which had proved to be a considerable political risk. The DAMA was to be headed by a two-person management board, appointed on a five-year contractual basis and remunerated upon annual targets. The business-like board model implied that the DAMA would be acting “self-responsible” (§ 1 section 1 DAMA draft bill) in a much broader sense than in the traditional presidential model which was tied to a hierarchical line of responsibility. The plan to limit the Ministry’s oversight to “urgent cases of preventive health protection” (§ 4 DAMA draft bill) would have allowed the Ministry to deny responsibility for a broad range of DAMA functions. An administrative board to which the senior management has to report (§ 7 sec. 1 draft DAMA) would have introduced an additional legitimacy buffer for the Minister of Health.

After the DAMA bill was re-introduced in 2007, due to an early general election, the pharmaceutical industry found itself alone in praising the reform. A business-like agency, privately financed, and presumably tied to the pharmaceutical industry, was depicted as a danger to health by consumer advocates, physician associations and former government officials (Der Spiegel, 2007; Tamm, 2007). In an opportunistic reversal of the preceding coalitional drift, Christian Democratic MPs, who supported the bill when in opposition, now placed themselves alongside the critics (Kurth, 2008). In addition, the reform lost much of its plausibility as the internal reorganization of the BfArM, supported by a massive growth of personnel, had already dissolved bottlenecks which, in turn, improved the BfArM’s performance at the European level. Lacking a deficient delegation as justification, which was the most important situation-related factor in this case, the DAMA bill was quietly shelved and the BfArM stopped being a cause of political trouble.

**Financial service regulation: From helping hand to grabbing hand**

As opposed to the previous case, the “Bundesanstalt für Finanzdienstleistungsaufsicht” (BaFin), created in 2002 by merging the agencies for banking, insurance and securities oversight, was widely perceived as a landmark in modernizing the German financial regulatory regime, which was badly in need to adopt to the blurring boundaries between the segments of the financial market (Frach, 2010; Westrup, 2007). Until then, the predecessors of BaFin had had a quiet life with both the banking and the insurance oversight agencies being part of a cozy triangle with their respective industries and the superior Ministry of Finance (Bundesministerium der Finanzen—BMF). Bureaucratic drift was not an issue so that oversight by the BMF mostly remained hands-off (Frach, 2010; Döhler, 2007) and seemed to be just as little a problem in relation to BaFin.

This started to change when the transformation of the global financial business made the BMF dependent on the expertise and manpower support of the BaFin (Handke, 2012). Especially the negotiating knowledge that BaFin acquired at the transnational level (Bach & Ruffing, 2013), for example during “Basel II” negotiations on banking, almost reversed the PA relationship.

---

3 In Germany still called oversight (“Aufsicht”) which has a less pro-active flavor than regulation. Regulation is perceived as rule-making for competition and consumer protection, whereas Aufsicht means supervising compliance with pre-existing rules (Handke, 2010, pp. 56–57).
It was the BaFin, not the BMF, who acted on behalf of the German government, thus becoming a financial services legislator of sorts. The fear of the BMF to be outmaneuvered by a subordinated agency seemed to be confirmed by the public high-handedness of BaFin’s president Jochen Sanio, a maverick but acknowledged financial expert. In an effort to restore the hierarchical PA relationship, the BMF published a guideline for technical oversight on its homepage in 2005, an uncommon procedure since oversight details are usually classified. The guideline can be read like a harsh criticism of the BaFin and demands “instantaneous information” under a number of meticulously defined circumstances (Bundesministerium der Finanzen, 2005). In addition, the tightening of banking oversight repeatedly raised criticism, expressed by bank representatives and conservative governors, who even urged the BMF to end BaFin’s “reign of terror” (Handelsblatt, 2005). When an internal corruption scandal surfaced in late 2006, Sanio was accused of mismanaging the BaFin (Der Spiegel, 2006; Frach, 2010). The BMF seized the opportunity to introduce a five-person directorate in which the president was downgraded to a primus inter pares, shoving the relations between BMF and BaFin into the doldrums.

The financial crisis, starting in 2007, caught many German politicians on the wrong foot. After years of promoting the liberalization of financial markets, the entire Centre-left coalition and especially the social democratic Minister of Finance were exposed to the political fall-out of the crisis. Prior to the crisis, Peer Steinbrück had been a deregulation advocate and had managed the approval of new financial products such as hedge funds or securitization. Given the announcement in the 2005 coalition agreement to reduce “superfluous regulations” and handle financial market regulation with a “sense of proportion” (Koalitionsvertrag, 2005, pp. 73–74; Frach, 2010, pp. 78–79), the Ministry and parliamentary BaFin skeptics had been irritated more than once by Sanio’s public demands for more personnel and additional regulatory competences (Financial Times Deutschland, 2006; Handke, 2012, p. 245).

The federal government, already under pressure after the collapse of Lehmann Brothers in September 2008, was even more concerned when, only a few weeks later, it turned out that the Hypo Real Estate Bank (HRE), a large mortgage lender, was on the verge of bankruptcy (Buder, Lienemeyer, Magnus, Smits, & Soukup, 2011). German government, afraid of a breakdown of the interbank lending market, was coaxed into a €35 billion bail-out by banking representatives during a crisis summit, only to be ramped up by another €15 billion a week later. Soon after, suspicion arose that the BaFin was part of the HRE disaster (Handke, 2012; Manager-Magazin, 2008). Work-to-rule, especially when the BMF should have been alarmed about looming financial risks, was portrayed as one of the causes for the near-bankruptcy (Manager-Magazin, 2009). Steinbrück and the BMF joined this chorus and blamed the BaFin for incomplete information (Bundestag, 2009). Due to its hierarchical position the BMF was able to issue a gag order, effectively banning BaFin president Sanio from making own press statements (Handelsblatt, 2008) while the alleged oversight failure (“Aufsichtsversagen”) became a buzz word in the media (Frach, 2010, pp. 104–105; Handelsblatt, 2008).

The amount of prior failures and miscalculations by the political principal explains the massive scapegoating at the expense of BaFin. The minister, being absent during the HRE rescue summit, had tried to allay fears by calling the subprime crisis a “purely American problem” (Die Welt, 2008) only a few days earlier. During the HRE rescue he increased the level of anxiety among already roused investors by mistakenly announcing the bank to be “wind down” (“abwickeln”) instead of being restructured (Die Zeit, 2013). It turned out later that the BMF had rejected a BaFin proposal in 2007 to close a regulatory gap relevant in the HRE case (Der Spiegel, 2009). A law amendment in summer 2009, which strengthened the enforcement powers of the BaFin during financial crises, thus appears to be the rectification of earlier omissions. But the most serious failure was the deficient flow of information inside the Ministry (Süddeutsche Zeitung, 2010), a classical trigger for invoking ministerial responsibility. Contrary to the BMF’s reproach that BaFin failed to provide explicit warnings, a parliamentary inquiry revealed that BaFin officials had frequently informed the ministry’s financial market division, stressing the critical condition of the HRE (Bundestag, 2009). But, the information rarely made it to the top of the BMF. During the inquiry, Steinbrück and both his secretaries of state argued that the information at hand did not induce further action (Bundestag, 2009). The principal thus created an artificial information asymmetry (Poth & Selck, 2009) to cover-up previous omissions and to dodge political responsibility. Compared to both other cases the HRE crisis triggered the most obvious moral hazard by a political principal who passed the blame on to the bureaucratic agent.

After the financial crisis had passed its peak, a behind the times yet interest-driven reform plan was put on the
agenda. Then Bundesbank president Axel Weber suggested in a “stunning pre-emptive strike” (Engelen, 2010, p. 55) the takeover of BaFin’s banking oversight functions by the Bundesbank. This idea was rapidly taken up by the newly elected center-right government and written into their coalition agreement in autumn 2009. The debate about the transfer of oversight functions to the Bundesbank was presented as a fix to an adverse selection, one of the classic deficiencies in a PA relationship. Adverse selection occurs when a principal chooses the wrong agent, most frequently because the agent only pretends to be better than others (Wood, 2010). In politics this can happen, for example, if a minister appoints a disloyal staff member or if a procurement contract is awarded to an underperforming firm. It is more difficult to imagine a government delegating a crucial regulatory function to the wrong agency from the outset. But, over the course of time, coalitional drift can make a bureaucratic agent look outdated even without bureaucratic drift. The justification for the reform followed precisely this sort of narrative.

Although the BaFin was already perceived as being an integrated supervisor, banking oversight was, and still is, shared with the Bundesbank which performs ongoing oversight mainly selecting information upon which BaFin takes regulatory decisions. Weber, supported by major banking associations (Engelen, 2010), portrayed a single supervisor as the more modern design. This argument was used by a drifting coalition in which the Bundesbank was joined by a handful of Christian- and Liberal-Democratic MPs with a pro-business background (Engelen, 2010). But the complaints about double-work or frictional loss, allegedly caused by the division of labor between BaFin and Bundesbank, appeared to be the routine wailing of a regulated industry rather than a persuading argument for reform. Even the new Christian-Democratic Minister of Finance showed little empathy for the zeal of his parliamentary colleagues (Die Welt, 2010b), thus leaving the coalitional drift incomplete. The reform plans were put into cold storage and ended with a law amendment in 2012 containing little more than “thin air” (Handke, 2012). Following the distinction between “helping hand” politicians, who aim at maximizing social welfare or correcting market failures, and “grabbing hand” politicians, trying to please voters or interest groups (Masciandaro & Quintyn, 2008, pp. 157–158), it appears as if a few grabbing hand politicians seized the opportunity to claim the credit for a though reform. The applause from the banking industry was already there and shredding a disputed agency might have yielded a cleaning-up-the-mess bonus for the reform protagonists. Compared to the handling of the HRE crisis, it would be overdrawn to classify this as outright moral hazard. But, at least the grabbing hand motive by implicit principals remains difficult to dispute. More generally, coalitional drift and the extended chain of delegation proved to be the most important drivers behind impending political costs in this case.

**Rail safety: From negligence to crisis**

The Rail Safety Authority (Eisenbahn-Bundesamt—EBA) did not emerge out of a crisis or as an institutional innovation as was the case with BaFin. The agency was rather launched as a by-product of the rail reform in 1994 (Lodge, 2002). The transformation of the state-owned Federal Rail into a stock corporation (Deutsche Bahn AG—DB) required the transfer of sovereign functions formerly managed in-house by Federal Rail, such as supervising technical, infrastructure and safety aspects, to a government agency. The EBA, subordinated to the Federal Ministry of Transport (Bundesministerium für Verkehr—BMV), was perceived as a purely technical agency with little involvement in the controversial regulation for competition. Accordingly, the EBA had an unspectacular start and received little political or public attention.

A long-lasting shock wave was sent through the EBA in summer 1998 when a high-speed Intercity Express (ICE) derailed near the small town Eschede, causing the most fatal rail accident in post-war German history with 101 dead and 88 severely injured. Even though the ICE construction, including the design of the steel tire that caused the derailing, had been licensed in-house by Federal Rail engineers as early as 1990, EBA was presumed to be a doxious regulator, not least because most personnel were inherited from Federal Rail (Brumsen, 2011). Nonetheless, Eschede marked a turning point by causing EBA engineers to move toward a tighter safety inspection regime.

From a PA perspective, the original delegation was deficient. Initially, the EBA was even forced to sue DB in order to clarify the range of regulatory competences (Grupp, 1996). A more outspoken restriction for rail safety enforcement was created by the initial public offering (IPO) of DB’s rail infrastructure subsidiary which was actively pursued under the Grand Coalition since 2005 and only put on hold by the

---

4This appears less surprising when considering that the Bundesbank already made a similar attempt in 2001, which aimed at compensating for the loss of importance caused by the creation of the European Central Bank, (Frach, 2010).

5Market regulation blossomed not before 2005 when the Federal Grid Agency was made responsible for strengthening rail competition.
financial crisis in 2008. The rail policy in the preceding years was often coined as “dressing up the bride” (Holzhey, 2006, p. 8), i.e., making DB interesting for potential investors. Then CEO Hartmut Mehdorn intensified efforts to brighten the balance sheet by cutting expenditures deemed less relevant, such as maintenance and repair including safety-related expenditures. The Ministry of Transport, which had subsidized track maintenance and repair since 1994, was criticized more than once for sloppy control of the DB’s use of earmarked money (Böttger, 2013; Bundesrechnungshof, 2006), but shied away from interfering with DB business operations. Especially the looming IPO tied the hands of the political principal, who, among others, eschewed the closing of regulatory gaps to strengthen the EBA (Behörden Spiegel, 2010). Although the EBA distanced itself from DB over time, it remained a constrained agent (Frotscher & Kramer, 2001).

Aside from inspecting rail operations, planning oversight and authorization of railway infrastructure, the licensing of new rolling stock became an increasingly relevant and controversial EBA function. During the monopoly days of Federal Rail, rolling stock was sparsely innovative, produced by a few private manufacturers who built rail cars, passenger and freight coaches based on construction plans provided by Federal Rail’s engineering division which then—reportedly—tested rolling stock “endlessly” (Welt, 2010a). This division of labor completely changed after the 1994 reform (Lange, 2015). The DB, eager to streamline its operations, passed over the responsibility for technology development, including safety and reliability testing, to rail manufacturers. In an effort to modernize its outdated rail fleet, the DB ordered ever more convenient and faster trains. The number of model series multiplied from a handful to more than sixty (Der Spiegel, 2002), not least due to private operators, who slowly entered the rail market.6 As the frequency of more diverse orders increased and rail technology leaped forward, the time-consuming licensing procedure put the EBA under stress. This situation was worsened by a series of law amendments and European “rail packages,” each assigning new functions to the agency. In contrast to the BfArM and the BaFin who both achieved significant personnel growth, the EBA could not prevent the downsizing of its staff from roughly 1,500 in 1994 to 1,200 in 2014 (Eisenbahn-Bundesamt, 2015). This largely remained a ritual point of criticism by labor unions and rail reform critics (for example Bundestag, 2013), thus making it easy for incumbent ministers to ignore additional demand. Eventually, however, the chronic shortage of EBA staff dangerously coincided with a new trouble-spot (Die Welt, 2013) that contained considerable political risk.

Starting in 2009 the rail industry accused the EBA of slow-going licensing, overburdening manufacturers and operators with unpredictable safety obligations (Handelsblatt, 2009). Interest groups such as the Pro-Rail Alliance increasingly pressured the Minister of Transport to eliminate “bureaucratic bottlenecks in the process of licensing new rolling stock” (Allianz pro Schiene, 2013). The situation had worsened significantly when the European Safety Directive (Directive 2004/49/EC), coming into effect in 2007, required each rail operator to launch an in-house safety management. The EBA was charged with supervising this process and then granting safety certificates, without which no rail operation would be permitted. Whereas DB easily complied with these regulations, a substantial number of the more than 300, mostly small and regional train operators were much less prepared to do so. The EBA’s handling of this problem, protracted by several temporary arrangements, came under heavy criticism not only from the rail industry. The Monopolies Commission, an independent advisory board, identified the EBA’s case by case approach as a major source for delayed or lacking safety certificates (Monopolkommission, 2011).

It looks as if the licensing problem was simply based on bureaucratic failure. But several other factors played a role in the upcoming storm. Since the early 2000s the relations between rail manufacturers and operators, including DB, had soured due to delays in delivering new rolling stock and technical problems during operation both of which were a result of the shortened product cycle and the lack of operating tests. The EBA was caught in the middle of the mutual finger-pointing and appeared to be a cost-driver, particularly since every major rail accident was answered with more painstaking safety inspections (Handelsblatt, 2009). The Ministry of Transport, being aware of the trade-off between rail safety and the industry’s desire for cost-saving, hesitated to get involved. But with the EBA being part of its own jurisdiction, the media already up in arms, and the licensing deadlock putting entire rail fleets on hold (Schuppe, 2013), the Ministry finally gave in. A first result of its round table diplomacy was a manual for licensing rolling stock, agreed upon

---

6By 2012, roughly 25% of the rail traffic volume, measured in kilometers, was provided by private competitors of DB, mainly in freight and regional traffic (Lange, 2015).
between officials from EBA, the Ministry and industry representatives in spring 2011. Since complaints about EBA continued, it seems that the goal to optimize the licensing procedure was missed. During a “rail summit” (Die Welt, 2012) in early 2012 the Minister of Transport threatened serious consequences for EBA if licensing was not sped up.

Compared to the previous two cases, this threat was less severe. Certainly, the Minister intended a preventive blame-shift in case his engagement in solving the licensing crisis would not work out. In this case, the belated intervention to amend the law that contributed to the licensing jam and the chronic understaffing of EBA would re-emerge. Fortunately for the Minister, the crisis did not augment into a question of ministerial responsibility. Much pressure was released when the EBA proposed the use of private experts as part of the licensing procedure (Der Tagesspiegel, 2013). A law amendment, coming into effect in 2015, authorizes on-site inspections by “notified” or “designated bodies,” only the results of which require final approval by the EBA (Lange, 2015, p. 35). Given that drawing on private experts for safety inspections is a well-known routine in Germany,7 it is puzzling why this simple solution was not put on the table earlier and is even regarded as a “paradigmatic change” (Bundesrat, 2014, p. 22). As a matter of fact, a “rail safety TÜV” (Handelsblatt, 2009) was on the agenda for some time. But, as long as this idea was promoted by the rail industry and economists only, it could not garner enough credibility to be realized. This changed when the EBA itself stepped in and presented an appropriate, yet unsurprising, solution which conveniently released the political principal from bearing the costs of a deficient delegation.

Discussion and conclusion

The previous analyses replace the “overemphasis on control” (Jones, 2003, p. 405), inherent in the PA mainstream, with a focus on the principal’s moral hazard. This analytical perspective not only runs counter to the conventional PA logic, but also serves as a reminder that political-bureaucratic relations should not be biased by a top-town view on bureaucratic failures. The exploitation of hierarchy by the political principal may be more abundant than the few cases under review would suggest. The aim of this analysis is to unveil the conditions under which the political principal is likely to engage in moral hazard. It starts with a distinction between two categories.

The context-related factors are institutionalized and thus mostly stable traits to be found in most parliamentary systems, but with particular modes of operation in the German case. Ministerial responsibility is latently dangerous because it can be invoked from outside the constitutional realm by the media or affected groups. However, hierarchical oversight serves as an institutionalized risk cushion for the political principal by enabling hidden action. Finally, monitoring costs constitute a particular problem in German ministries whose personnel resources are mostly absorbed by law drafting and coordination activities. This suggests that the “midsection,” represented by the ministerial bureaucracy, in charge of the oversight function vis-à-vis agencies, can play a role of its own. If crucial information, as was the case at times, is not properly transferred to the top, blame avoidance or even moral hazard becomes part of the feasible set of the ministerial principals. These context-related factors need to be engaged by situation-related factors, the frequency and allocation of which is summarized in Figure 1.

(1) Critical situations represent a linchpin for the analytical framework not only because of their signaling function. Crises are routinely classified as bureaucratic failure in public or as bureaucratic drift in the conventional PA perspective. As the previous cases have shown, however, such situations are often caused by the coincidence of several influences. Crises, in combination with other situation-related factors, serve as a catalyst for the principal’s moral hazard. Political principals, to name only one “original sin,” tend to turn a deaf ear on the demands of the bureaucratic agents for more resources or regulatory power. Such omissions may backfire during situations in which culprits are wanted. But, this should not be expected across all types of policy. The empirical analysis focused on risk regulation which, at best, works unobtrusively, but is not suited to yield great political benefit. It has to be considered, in addition, that the principal often inherits delegation in such a way that bureaucracies are set up and charged with function years or even decades ahead. As a result, the political principal has few incentives to invest much effort and attention into an inherited agent with little potential for political earnings.

(2) Deficient delegation applies to functional aspects of implementation and appears in various nuances. Goal conflicts, implanted into an agency’s mandate from the outset, represent a modest form of deficient delegation because risk deferral is not outspoken but rather implicit. An even less deficient type of delegation occurs when unpredictable consequences of a delegated mandate are prompted by dynamic environments so that the ‘rules of the game’ are changed. This should not be coined deficient delegation unless the principal

---

7 Even in high-risk technologies, such as nuclear energy, private technical inspection associations (Technischer Überwachungsverein—TÜV) play an important role.
deliberately shuns away from closing regulatory gaps in an effort to please the regulated industry or other interest groups. Thus, deficient delegation comes closer to principal's moral hazard if a regulatory update is rejected due to grabbing hand motives.

The remaining two situation-related factors occasionally overlap, which is why it is necessary to clearly spell out the distinction between the two. (3) Coalitional drift appears in two versions. The explicit version refers to changing political majorities as a result of general elections, and gives little reason for principal's moral hazard. The implicit version, which is more interesting in the present context, occurs if interest groups, the media or other stakeholders pressure a political principal. In this case the political principal can drift, i.e. join the new coalition, but is not forced to do so. (4) The chain of delegation, by contrast, operates if an additional principal, mostly based on implicit delegation, enters a dyadic PA relationship. Single MPs, the minister's own party, or the media can act as principals who, despite there only being an indirect chain of delegation, are able to turn a minister into an agent. Thus, the chain of delegation invokes a sort of authoritative relation, whereas implicit coalitional drift is based on interest group pressure. Both implicit coalitional drift and the chain of delegation can produce costs for the political principal, even though they operate based on different mechanisms. This can now be summarized into a sequence which indicates the likelihood for the principal's moral hazard to emerge.

First, context-related factors provide opportunities for action within PA relations. This includes more or less options for the principal's moral hazard. Second, situation-related factors create incentives for moral hazard. The case studies imply that crises mostly serve as a focusing event in which the principal is confronted with political costs, which will rise in combination with deficient delegation, implicit coalitional drift and modifications in the chain of delegation. Third, these factors

Figure 1. Timelines of events. Note. The grey columns beneath the timelines attribute the situation-related factors (Table 1) to each segment. The intensity of influence is charted in a four-stage scale: white means absence, whereas the grey shades indicate the strength (weak, medium, strong) of factors operating, with dark grey segments indicating the strongest impact.

Figure 2. Sequence of principal–agent interaction.
are transformed into a reaction that either leads to moral hazard by the principal or to a different course of action. The empirical cases suggest that the tipping-point in favor of moral hazard is reached if at least three situation-related factors coincide and the principal's contribution to the crisis becomes visible for a broader audience. The sequence in Figure 2 represents a rough approximation of factors leading to the principal's moral hazard which contributes to our understanding of political-bureaucratic relations beyond the blinders of conventional PA reasoning. Even if this will not be the end to further elaborate the PA concept, considering the principal's moral hazard represents an important step at refining the PA concept into a direction that covers more real world situations.

Acknowledgment

A first version of this article was presented at the ECPR 6th Standing Group on Regulatory Governance Conference, Tilburg University, July 6–8, 2016. I would like to thank my colleagues Christina Lichtmannegger, Sylvia Pannowitsch, Eva Ruffing, and Ronja Wöstheinrich for useful comments and suggestions.

References


