



Improving the Relationship between Citizens and Politicians: Some Economic Remarks from an Agency- Theoretical Perspective

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Abstract: The decision of the Dutch government to entrust a state commission with the question of how to improve democracy is to be warmly welcomed. Political disenchantment—a strengthening of radical movements and a growing skepticism towards politics of large sections of the population—is not a national peculiarity; it affects many Western states. The present paper would like to enrich the discussion by analyzing the relationship between citizens and politicians from an economic point of view, starting with Germany. To this end, we use a principal-agent approach and derive implications about the measures that could be taken to mitigate the moral hazard problem. With respect to the corporate sphere, the central research question of this paper is: *What can we learn from corporate governance to reduce the problems of the relationship between citizens and politicians?* The paper aims to give at least first answers to this question. Our proposals are not conclusive, and importantly, economic theory should be supplemented in the future with insights from other disciplines. The implications, however, move highly relevant issues into focus and open them to a critical discussion by science, media and politics.

Keywords: Public Choice, democracy, agency, reforms, sanctions, compensation, politicians, governance, decision-making.

JEL Classification: D72 ; D78 ; H10 ; Z18

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1. Introduction

The Dutch government's move to set up a state commission to ensure democracy in the future is to be warmly welcomed¹ (Brouwer and Staal 2020). Against a background of growing disenchantment with politics among large parts of the population in almost all European countries, manifesting in a strengthening of radical parties, the problems with the current political system must be addressed. In Germany, growing skepticism towards the established parties has been evident since 2015, at the latest. In Follert (2018), I attempted to analyze this disenchantment with politics from an economic perspective. In particular, I identified the tensions in the relationship between citizens and politicians. If one understands this relationship as an agency, the recourse to economic theory provides fruitful implications about which measures can be used to mitigate the discretionary leeway that naturally results from an agency. Thus, to contribute to the discussion on improving democracy, essential aspects of Follert (2018) will be outlined in more detail. The core hypothesis is that voters tend to elect those politicians who are most likely to represent their preferences (Stadelmann et al. 2013). A control problem arises regarding the satisfaction of voter's preferences in operational activities. Nonetheless, even though the political systems of the Netherlands and the Federal Republic of Germany are not identical (Brouwer and Staal 2020), the paper discusses only a *model* of parliamentary democracy, especially a model of the relationship between politicians and citizens.

In section 2, I will outline the theoretical framework. The relationship between citizen and politician will be characterized as an agency from which various problems arise from the assumption of the agent's self-interested and in part opportunistic behavior. On the basis of this theoretical classification, section 3 suggests three parameters that could be changed to improve the system. The final section 4 summarizes the results. insights

The paper would like to contribute some ideas to the discussion initiated by Brouwer and Staal (2020). In particular, it aims to show which control and incentive measures could lead to an improvement in the relationship between politicians and citizens in a way that politicians see

¹ <https://www.staatscommissieparlementairstelsel.nl/>

themselves more as representatives of the population on the one hand and citizens rebuild more trust in their agents on the other. Understandably, critics may be irritated by the idea of politicians as agents of citizens. However, this simple illustration may help to focus the discussion on the crucial points within the relationship between politicians and citizens. The mechanisms presented should be seen as an impetus for discussion. The central question in this essay is: *What can we learn from corporate governance to reduce the problems of the relationship between citizens and politicians?* The paper tries to analyze this question from a corporate governance-perspective. To this end, we will identify crucial mechanisms of a capitalist market system and discuss their transfer to the political sphere. The reader should not get the impression that the mechanisms can be transferred without operative adaptation. Nevertheless, we can derive important implications from corporate governance, which may possibly improve the relationship.

2. Democracy and Agencies

In an ideal democracy, in which parties compete for voters, the problems discussed here would not exist. However, competition in real democracies is highly imperfect. If one follows Becker (1958), and conjecture that the resulting problems in the political sphere were at least as serious as in business competition, it seems obvious to base the problem analysis on the findings of economic theory. Since we would like to deal with proposals to improve democracy, it could be beneficial to first discuss the meaning of the term. Already, von Hayek (1979: 5) emphasizes the consequences of an inflationary use of the term “democracy”, which leads to a dilution of the original meaning of the word:

As seems to be the fate of most terms expressing a political ideal, ‘democracy’ has been used to describe various kinds of things which have little to do with the original meaning of the term, and now is even often used where what is really meant is ‘equality’.

The present essay deals with citizens and politicians so that a conceptual approximation should be made first. The term "citizen" originally described free and full participation in society (Weber-Fas 2000: 67), which makes the citizen an actor within the political system. In the following, we understand the citizen in general as a person entitled to vote

(Follert 2018). Both citizen and politician are assumed to be “average [actors]” (Downs 1957: 7). The term “politician” literally means a “statesman”. While Follert (2018) takes a differentiated view of the members of a parliament, for the sake of simplicity it should generally be based on actors who stand for election to represent their voters in parliament, which results in a mandate relationship (Richter and Furubotn 2010; Follert 2018; on the interpretation as a contractual democracy, see Gersbach 2012; 2017).

According to the Public Choice literature (e.g., Schumpeter 1950; Downs 1957; Niskanen 1975; Buchanan and Tollison 1984; Frey 1994), the actors within the political or bureaucratic system act as self-interest maximizers, who acts under incomplete information and uncertainty. An extended picture of *homo oeconomicus* is therefore assumed here (e.g., Lindenberg 1985; Opp 1985; Kirchgässner 2013; Emrich and Follert 2019).

Principal-agent-relations are characteristic of (parliamentary) democracy (Richter and Furubotn 2010). The agency-theoretical view of the political system is already established in political science (e.g., Lowi 1969; Pollack 1997; Strøm 2000; Besley 2004; Döhler 2007; Geys and Mause 2012). Delegation relations occur in democracies on several levels (Follert 2018), for example, between a cabinet and the ministers (Andeweg 2000) or between the voter and the elected. Here, the citizen is the principal, who delegates representation to the politician as principal. Usually, a principal-agent relationship is accompanied by an asymmetrical distribution of information from which control problems for the principal arise both before and after the conclusion of the contract (e.g., Spremann 1990). In the special case of the agency, which is the focus in this paper, these control problems arise because politicians pursue different goals than citizens, and thus a divergence of interests. Downs (1957: 28) assumes that the politician maximizes utility under the secondary condition of obtaining enough votes for re-election; and “that they act solely in order to attain the income, prestige, and power which come from being in office. [...] their only goal is to reap the rewards of holding office *per se*. They treat policies purely as means to the attainment of their private ends, which they can reach only by being elected.” However, the secondary condition only applies if further rounds are “played” (in the game theoretical sense). But if a politician decides not to stand for re-election, a moral hazard problem arises in addition to the well-known “lame duck” phenomenon (e.g., Krell

and Spich 1996), since the citizen can no longer impose sanctions in the next round (Daumann and Follert 2020).

The economic analysis of such principal-agent relationships may be considered well developed with regard to the relationship between the shareholders of a public-stock-company and the employed management (Jensen and Meckling 1976). An aspect of such a company is the separation of ownership and control. Within the framework of organizational theory and the field of corporate governance, numerous instruments show how the moral hazard risk can be reduced. In the following, fundamental implications from this line of research will be applied to the relationship discussed here and, in particular, proposals will be made in the areas of *sanctioning*, *monetary compensation* and *liability*.

3. Learning from Corporate Governance: Some Proposals

Corporations are characterized by the separation of ownership and control. Shareholders transfer power to management, which is to act as an agent for the principals. But an asymmetric distribution of information and diverging interests between principal and agent leads to several problems before and after the conclusion of the contract. Economic theory has therefore developed various mechanisms that attempt to mitigate those problems. Although the proposals of standard economics, especially (negative) incentives, could have also negative effects (e.g., the “crowding-out” effect, Frey 1997; further Deci 1971), it is certainly possible to modify the mechanisms in the operational implementation.

3.1 Sanctioning Options

In most parliamentary democracies, the people elect the parliament for a term of office – in Germany and the Netherlands for example for four years. In general, as sanction for misconduct, the principal (i.e., the citizen) only has the possibility to sanction the behavior in the next election. Obviously, this possibility only exists if the politician stands for re-election. In the case of stock companies, the annual general meeting must reaffirm its confidence in the management board every year. If we

apply this principle to politics, it could be argued that shorter election periods can lead to short-term oriented actions of the agent.²

A rapid rotation of offices is not a new idea from a historical perspective. For example, we see it in the early Florence of “the golden age” (especially in the 14th century) (Brucker 1998). There, the *priori* and the *gonfalonieri* as members of the *signoria*, the executive power, rotated every two months, and the legislative council once a quarter (Sintomer 2016). These short terms of office were also combined with random elections so that parallels can be drawn with the aleatoric democracy in Athens (e.g., Frey and Osterloh 2016; Sintomer 2016). Short terms in office can lead to considerable problems, particularly with regard to the competence of the candidates³ selected by lot and the lack of learning effects during shorter periods. Therefore, electoral system reform could be carried out in such a way that it remains an ordinary legislative period of multiple years—to enable the members of the parliament to build up appropriate task-specific human capital—but with the possibility of allowing for dismissal in the case of misconduct (Follert 2018). Dismissal should apply when politicians break election promises without sufficient justification (Follert 2018).

Of course, the precise operationalization of such a possibility would be subject to specific challenges, but the very idea can stimulate a discussion concerning the sanction of malpractice within the political arena. Similar to the board of a public limited company, politicians should present a clear catalogue of objectives for an interim period of one year at the beginning of their term of office. The objectives should be sufficiently concrete to allow voters to examine them. At the end of the first year, the politician could then submit an accountability report explaining and justifying any deviations. The voter would have the opportunity to accept these deviations if they were considered reasonable and justifiable. In the other case, the voter can sanction the politician by withdrawing trust. This argument obviously implies an extension of the political mandate if the

² <https://www.faz.net/aktuell/politik/inland/politiker-aller-bundestagsparteien-fuer-verlaengerung-der-wahlperiode-15197765.html>

³ On disadvantages of aleatoric procedures, see, e.g., Frey and Osterloh (2016: 6f). Probably the most serious disadvantage of a random procedure lies in the incompetence of a candidate. However, due to the prevailing information asymmetry and the resulting hidden characteristics, voters also could find it difficult to distinguish between competent and incompetent candidates.

politician performs well. (For this mechanism in contractual democracy, see Gersbach 2012; 2017.)

3.2 Monetary Compensation

In parliamentary democracies, it is customary for politicians to decide on their own monetary compensation. This system is problematic because the remuneration is paid from general tax revenue. If this decision were interpreted as a remuneration contract, the politician acts on both sides of the contract (Follert 2018) so that the amount of remuneration is largely beyond the control of the principal. From an economic perspective, this situation creates false incentives, especially since the remuneration as the price for work performance could exceed the marginal utility of the principal (Follert 2018).

A comparison of the level of remuneration of Bundestag members in Germany with other top civil servants, such as top scientists, is striking. A professor (W3) receives (June 2020) a monthly base salary between 6,256,08 EUR (min, Hesse) and 7,118.08 EUR (max, Bavaria),⁴ whereas a member of the German parliament earns (July 2019) 10,083.47 per month⁵ (but less so in the Netherlands⁶). The high compensation could be justified by citing the high opportunity costs of foregoing a job in the private sector. If correct, members' compensation could also be contractually regulated, for example, by stating in law that a politician's remuneration would be based on an average value⁷ from the last five years from the politician's previous employment; a position more in keeping with the merit principle and the idea that investment in education should pay off. Such a differentiation would be an economically justifiable approach that 1) considers the actual opportunity costs (see already Meyer 1998); 2) prevents remuneration from being an incentive to change to politics, regardless of the intrinsic motivation to do so; and 3) compensates for the

⁴https://www.hochschulverband.de/fileadmin/redaktion/download/pdf/besoldungstabellen/grundgehaelter_w.pdf

⁵https://www.bundestag.de/abgeordnete/mdb_diaeten?url=L2FiZ2VvcuRuZXRIL21kY19kaWFldGVuL21kY19kaWFldGVuLTIxNDg0OA==&mod=mod454214

⁶In the Netherlands, a professor receives on average about 6,000 EUR (<https://www.nationaleberoepengids.nl/hoogleraar>) and a member of parliament at least 7,750 EUR (<https://www.nationaleberoepengids.nl/lid-tweede-kamer>) per month.

⁷ I would like to thank Carlos A. Gebauer for this idea.

uncertainty of choice with a risk premium on the base salary. However, the proposal also poses serious problems. The difficulty is to find a compensation principle for the members of a parliament that would retain control in the hands of the principal without driving down politicians' salaries to a level that only people with independent means could accept. Yet, supporters of a particularly talented politician could be found to provide financial compensation. In the United States, as well, election campaigns are often financed by private donations. Obviously, private donations are accompanied by corresponding risks of lobbying. However, in professions that require a high level of intrinsic motivation, the established tradition is for people to finance themselves by private sources, for example, in science (see Weber's (1919) "Wissenschaft als Beruf").

Another potential argument against an individual compensation scheme is that the central principle of "equal pay for equal work" is violated. However, jobs for which individual remuneration regulations are common practice are in place. For example, the different remuneration of players on a professional football team. We can imagine on the one hand a defender who will earn less on average than a forward, even though both play 90 minutes. Moreover, the profession for politicians is not very standardized, so it is by no means certain that several members of parliament will do "the same" job.

3.3 Liability

The correspondence of decision and liability is a core aspect of market economy (e.g., Eucken 2004) and should also be a central characteristic of democracy. As agents, politicians have large sums of taxpayers' money at their disposal. However, they themselves are only responsible as administrators of the money during their term in office (e.g., Hoppe 2018). So, because of their time preference, politicians will likely tend to incur debt at the expense of later generations. In particular, the research concerning political business cycles (e.g., Frey and Lau 1968; Schneider 1974; Frey and Schneider 1975). Nordhaus (1975) shows that Downs's (1957) self-interest axiom is also reflected in practical economic policy and the need for regulations that provide incentives that limit this behavior a priori. In a democracy, therefore, precautions must be taken to limit the politician's scope of possible choices so that each politician acts in the interests of the principal. Responsible decisions can be supported by appropriate liability (Gebauer 2016, 2019; Follert 2018). Of course, this

liability must not be arbitrary, but consider the specific uncertainty of political decisions.

The so-called "business judgment rule" has a long history in the United States; the rule guarantees a "safe harbor" for board members provided they have acted in a recognizably responsible manner (e.g., Merkt 2017). Also, in the German Stock Corporation Act (sec 93 subsection 1 sentence 2 of the German Stock Corporation Act) a corresponding rule has been introduced: "No dereliction of duties shall be given in those instances in which the member of the management board, in taking an entrepreneurial decision, was within his rights to reasonably assume that he was acting on the basis of adequate information and in the best interests of the company."

Obviously, managers can escape liability if they make an *entrepreneurial decision* based on *adequate information* and in the *interest of the company*. This position makes sense in light of the uncertainty of future environmental conditions; otherwise, liability could possibly favor particularly risk-averse behavior (on entrepreneurial decision-making in this context see Olbrich and Rapp 2013). In a figurative sense, political decisions are also characterized by a high degree of uncertainty and are therefore comparable with entrepreneurial activity in corporations. Thus Follert (2018) also pleads for a corresponding regulation in the political system, such as a "political judgment rule." Of course, one could contend that politics and business are not comparable. However,

the situation is comparable and can be analogized. Both representative bodies [politicians as well as managers, F.F.] face the same challenge: they have to make decisions for a future they cannot know. A board of directors must be able to explain, explain and, if necessary, prove in retrospect that it acted with the diligence of a prudent businessman. That he or she has taken into account all available information and, if necessary, consulted experts (Gebauer 2019, translated F.F.).

Since public prosecutors, as part of the executive, may be reluctant to prosecute politicians, an independent commission could be established to investigate gross offences. At least some members could be chosen at random. Frey and Osterloh (2016) argue for an aleatoric democracy (Frey

2017).⁸ The representatives of the population thus selected could be assisted in their investigations by experts from the judiciary, science, or business. Overall, two effects would possibly result. On the one hand, the threat of liability would lead to the more careful reconsideration of decisions and behavior that tend to be oriented towards the interests of the principals. On the other, politicians would be forced to give precise reasons and explanations for decisions they take to the citizens under uncertainty and in good conscience, which would result in a better understanding for politician's actions who often act under external pressure and which could help to improve the citizen-politician relationship.

It is not the intention of this idea to ruin politicians financially by claiming damages. Rather, the aim is to control their behavior a priori within the framework of decisions, the consequences of which hardly affect a decision-maker's personal situation but do influence other individuals to a great extent. From the politicians' point of view, these are so-called low-cost decisions (Kirchgässner 1992).

4. Concluding Remarks

The present paper is devoted to a specific aspect of the question "How to improve democracy?", namely the relationship between citizens and politicians. To this end, we interpret the relationship as an agency with the specific problems of such delegation relations. The paper analyzes the question: *What can we learn from corporate governance to reduce the problems of the relationship between citizens and politicians?* We outline well-known mechanisms that may help to reduce the specific problems resulting from the agency between politicians and citizens. The recourse to the economic theory of the organization shows that certain parameters exist whose partial change could lead to significant effects of confidence-building among citizens. At present, the relationship between citizens and politicians is often characterized by mutual distrust. Politicians should be motivated to act as agents of their voters. In so doing, they should still make decisions with responsibility. However, the citizen should be given

⁸Frey's essay triggered an intensive reaction in the scientific community: see *Homo Oeconomicus*, Volume 34 (2017) and Volume 35 (2018). However, the focus was on the discussion of referenda, strongly suggested by Frey (2017).

the possibility of stronger sanctions and the politicians should take responsibility for their actions in the form of liability.

Importantly, the present analysis is based on certain assumptions that, admittedly, do not reflect every conceivable, real situation of individual behavior (e.g., Downs 1957). Moreover, mechanisms from the corporate context are not necessarily transferable to the political sphere. Nevertheless, core aspects can be identified from the stereotypical consideration, which deserves a broader discussion in science, media and politics. The present paper aims to raise awareness of these parameters and thus to contribute to the improvement of democracy. In the context of such—sometimes unorthodox and obviously provocative—proposals, the aim is not to clarify every single operational feasibility. Impracticability (Fox and Johnston 2017) can therefore hardly serve as an argument. A critical discourse within the scientific community, such as the one triggered by Frey's essay (2017), can be helpful for the further development of seemingly irrefutable circumstances and to improve democracy.

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