4. To be or not to be? A general economic theory for public law: examining the benefits and costs of state intervention

Legal textbooks use, more or less, the same descriptions. Public law is divided into two distinct fields: constitutional and administrative law. It comprises a special body of rules that is applied to entities included in the State or interrelated with it. It governs the actions of such entities when they use public authority to pursue the general interest. This description does not encompass any existential dilemmas. Public law is an axiom, a given, which is not worth querying. Like the State it just exists.

Economic analysis does not confine itself to that approach. It raises a purely existential question: *why is there public law?* Why create a Demos besides the Agora? As one could imagine even before reading the following pages, economic theory seeks the answer in the performance of State action. Public law and its institutions exist only insofar as they successfully address certain needs. To paraphrase Descartes: 'they are useful, therefore they exist.'

To be or not to be? Should there or should there not be State intervention and, so, public law? In certain cases, the formulation of a question is more important than the answer itself. We owe this to Coase and his theorem, perhaps more than we do to the solutions that he himself tried to offer. As to how economic theory answers the question, there is no doubt: public intervention is justified only 'if' and 'up to the point that' it is efficient. The efficiency test clarifies if and how a specific matter is better off being treated by non-consensual institutions. Public law is born after assessing the 'pros' and 'cons' of State intervention, which economic analysis usually describes as (public) 'regulation'. This balance is crucial. It explains *why* public law exists.

It is, therefore, extremely important to assess the benefits (section 1) and costs (section 2) of public intervention. We will start with the advantages. Since horizontal institutions (societies, markets) are, according to economic theory, in principle more efficient, we need to understand why and when this principle is reversed. In other words, we need to address the circumstances under which a goal of general interest is poorly achieved through consensual relationships and better managed by the Demos (public interest theories of

regulation). We will then turn the spotlight on the disadvantages of State action. Can the public regulator *really* defend the common good? Instead of serving it, does it perhaps end up caring more for private interests (private interest theories of regulation)? This question lies at the epicentre of economists' discussions about the role of the State. Some focus on market failures, others on those of the regulator.[1]

1. THE BENEFITS OF PUBLIC INTERVENTION

Even when people are free to choose, they do not always achieve the optimal satisfaction of their needs. The imperfections of the Agora are the reason that justifies the intervention of the Demos (section 1.1), together with the ability of the latter to correct those imperfections by using its unique powers (section 1.2).

1.1 Public Regulation: the Answer to the Shortcomings of Private Action

Public action remedies the shortcomings of private society in three, partially overlapping, fields. The first focuses on market failures and the need to regulate them (section 1.1.1); the second on the limits of human rationality that render a paternalistic, top-down intervention necessary (section 1.1.2); and the third on public goods, for which no viable market can exist (section 1.1.3).

1.1.1 The 'invisible hand' is insufficient

State intervention is necessary because markets do not operate under ideal conditions.[2] Their inefficiencies require the use of public force, in the form of provisions to ensure fair competition. A public law of the market is important in order to remedy pathologies mainly attributed to firms. Public intervention is even more indispensable in the case of natural monopolies. The State grants exclusive rights for exercising those activities, in order to avoid destructive competition. It must supervise the holders of those rights so that they operate in socially satisfactory conditions as to pricing and secondly to quality, and so that they do not abuse their privileges.

Simply correcting the markets is not enough. Even when they seem to function properly, they face cyclical crises and systemic flaws (inflation, unemployment, inequalities). To counter them, a mechanism *above and*

---

[1] *Ogus* 1994, 2001, 2004a; *Hägg* 1997; *Den Hertog* 2010, 2012; *Hantke-Domas* 2003; *Veljanovski* 2010; *Feintuck* 2004.

[2] *Greenwald/Stiglitz* 1986.

outside everyday transactions is needed: a public law of the economy, with a broader, strategic agenda. If left alone, the 'invisible hand' is not sufficient to ensure a minimum level of prosperity for all over time; nor can it attain tactical objectives, such as stability and sustainability.[3] Accordingly, the value of redistributive public intervention in the economy is undisputed. The market is incapable of undertaking that function since it often leads to a concentration of wealth. Redistribution is then necessary in the name of social justice and also to render the use of goods more effective, in view of their diminishing utility when they accrue only to the few.

1.1.2 Defective rationality and 'necessary' paternalism

Non-consensual institutions protect us from rationally deficient choices in various aspects of our life. They reduce information deficits by requiring disclosure and by deterring situations of moral hazard or reverse selection: this is the role of consumer protection rules. Similar tools are used to counter principal-agent problems, as in the case of regulating specific professions (lawyers, brokers). In other fields, public authorities go even further. They impose compulsory behaviour in the form of general norms and prohibitions. By doing so, they substitute their own choices for those of private individuals, in matters such as road and food safety, hygiene, work conditions, education, town planning. The list is far from exhaustive. The common ground of that form of interventionism is that it does not serve objectives of a primarily economic nature. Rather, it constitutes a *social regulation* of specific human activities promoting various aspects of social welfare.[4]

The compulsory substitution of individual preferences is needed for several reasons.[5] The first is that people suffer from informational asymmetries of a technical or scientific nature. They are unaware as to how harmful it may be to consume a specific chemical substance, or how dangerous a toy can be. The second is that they selfishly promote sub-optimal choices, disregarding the externalities of their transactions: an entrepreneur who conceals the dangerous

---

[3] As Joseph Stiglitz notes, 'whenever there are externalities – whenever the actions of one individual entail consequences for others, for which they do not pay and are not compensated – markets do not work well'. Altman D., 'Q & A with Joseph E. Stiglitz'. Managing Globalization (blog), The International Herald Tribune, 11.10.2006. See also *Stiglitz* 1989. Nevertheless, as Coase made clear with his theorem (see Chapter 3, section 1.3), we should not exaggerate in discovering externalities everywhere in human action that need to be cured through public intervention.

[4] The same occurs when the State turns to the market for providing public services. Their economic regulation is not enough. There is also need for intervention with a purely social objective, such as rules for safeguarding the confidentiality of communications for mobile telephony providers.

[5] *Jolls/Sunstein* 2006.

properties of his products; consumers who prefer cheap but unhealthy food or an environmentally hazardous product. The third is that they are not ready to co-operate, even when it would be beneficial to them. Let's remember the prisoner's dilemma.[6] This shortcoming is commonly seen in everyday life, *inter alia* in waste collection and recycling. The fourth is that even when they wish to do the right thing, their rationality is bounded. They overrate their driving skills and drive recklessly if they envisage no risk of paying a high fine or having their licence suspended. They enter into a burdensome loan agreement because they fail to see what the future holds for them – like the inhabitants of the Easter Islands who cut down the last trees in order to transport their idols. The final reason is that they may not be really free to choose the best options – such as when they are in a grievous financial situation and so agree to borrow on usurious terms, or to be recruited into a squalid and dangerous working environment.

Since people are incapable of living happily by only using their freedom and logic, vertical intervention seems necessary 'for their own good and for the common good'. Economic theory understands that public action involves *paternalism*, especially when it redirects or substitutes 'deficient' private behaviours. It lends such action a purely economic (not moral) justification, and not in all circumstances. Paternalism is justifiable only if it proves to correct the inherent shortcomings of individuals and consensual institutions in ensuring the optimal satisfaction of needs.

Individuals' egoistical and non-co-operative behaviour, or 'cognitive blunders' (a term coined by Cass Sunstein), will always exist.[7] A person cannot efficiently choose for himself/herself where he/she will build a house: he/she will construct buildings everywhere and then deny others the right to build 'in his/her backyard' (a phenomenon known as 'NIMBYism')[8]. Similarly, a person cannot efficiently choose whether he/she will opt for nuclear energy instead of lignite; his/her irrational and scientifically unjustified fear of nuclear accidents does not allow him/her to weigh the pros and cons in a dispassionate and objective way. *But what is the ideal 'dose' of paternalism?* Instead of imposing prohibitions and compulsory behaviours, would it be more appropriate to encourage and 'nudge' people in the right direction?[9]

---

6 See Chapter 2, section 3.2.1.

7 *Klick/Mitchell* 2006.

8 *Richman/Boerner* 2006.

9 *Sunstein/Thaler* 2003; *Sunstein* 2011a, 2013; *Kirchgässner* 2017; *Alemanno/Sibony* 2015. On the legal limits of nudging, *Van Aaken* 2015. See Chapter 10, section 3.2.

1.1.3 Ensuring public goods: a beneficial field for public action

In addition, the Demos is necessary for covering needs that only it can satisfy. This applies by definition to public goods, those not supplied in conditions of excludability and rivalry.[10] Such goods are subject to missing market conditions. No one has an incentive to produce a commodity that others are not obliged to acquire by paying a consideration (for example, a clean environment): a hypothetical producer cannot exclude third parties who do not wish to pay for access to that commodity. Public goods are more exposed to collective action problems, especially to the free rider phenomenon. Therefore, it is not possible to ensure that their availability is satisfactory through private initiative. This explains, from an economic standpoint, why ensuring public goods has historically been the optimum field for public intervention – the main reason for the development of non-consensual institutions and of the State itself.[11]

Let's begin with public order. Shaping a framework of peaceful co-existence is the oldest public good provided by the Demos in ancient Athens or Rome. Only non-consensual institutions are able effectively to undertake this objective: first, by policing and punishing offenders/free riders that set it at risk; second, by creating the infrastructures (military, police, justice) to provide relevant services. When the State became democratic and liberal, public order was linked to another notion: the rule of law. The rule of law, and legal certainty – as foundations of western constitutionalism – are public goods. They cannot be obtained via individualised transactions; rather, they have a 'systemic' character.[12] They presuppose a broader framework of behaviours, actions and structures, whose creation requires public supervision and intervention. All those within the 'system' of the rule of law – even its enemies, such as ideological objectors or habitual offenders – enjoy its benefits without paying consideration and equally with others, as is the case with any public good. For example, tax evaders or those who reject the principles of western democracy are not deprived of the guarantee of a fair trial for those reasons.

Economic theory refers to a vast variety of public goods. Some seem more familiar: roads, lighthouses (despite the objections of the Chicago School),[13] open parks; or water supply and drainage networks, which historically were

---

[10] See Chapter 2, section 1.1.1.

[11] *Touffut* 2006; *Olson* 2002 (1965); *Cornes/Sandler* 2008; *Hardin* 1997; *Vanni* 2014; for a critical perspective, see *Friedman* 1987; *Demsetz* 1970.

[12] According to the 'anarcho-capitalist', ultra-libertarian approach, there can be private providers even for those goods, including national defence services. I do not share this view. For this debate, see *Cowan* 1992; *Cowan/Sutter* 1999; *Caplan/Stringham* 2003.

[13] *Coase* 1974; *Candela/Geloso* 2019; *Stringham* 2007.

among the first public utility infrastructures undertaken by the Demos. Some others are less obvious: 'confidence in the economy' or 'quality of life' are in this category. The first – on which economic growth depends – is created only if a proper regulatory and tax environment is established for *all* transactions, with appropriate supervision and enforcement mechanisms against *all* illegal conduct, and so with effective policing and justice. Quality of life, a term almost synonymous with welfare, is connected to the broader social, cultural and environmental conditions in which a person lives. These can only be guaranteed by systemic and long-term public regulation. The holistic nature of such goods, and their availability to all without direct payment of consideration, confirms their public nature. Their listing cannot be exhaustive, as they reflect the evolving and limitless nature of human needs.[14] Indicatively, sustainability and biodiversity – two priorities born in our modern 'risk societies' and transformed into legal notions, such as sustainable development and the precautionary principle – constitute an advanced form of public goods that require the 'visible hand' of public authority.

There are also goods that are provided or that can be provided within the market, but not in conditions of a socially acceptable allocation of resources. These too present a public dimension and constitute partially public goods. Merit goods, to which we have already referred,[15] fall under that category. Their satisfactory supply comes up against the reduced incentive of private individuals to enter into the necessary transactions.[16] For both health and education – the typical examples – there is private supply: private schools, medical consultants, hospitals. However, the activity of such private providers will not fully satisfy the needs of the entire community at an accessible price. Their rational refusal to provide these services in non-profitable terms leads a society to Calabresi's 'tragic choices'.[17] Economic analysis of law justifies their partial conversion into public goods and 'social rights', constitutionally guaranteed by the State. The same goes for public utilities, such as energy, postal services and electronic communications. Even when private providers for these utilities exist, they do not ensure on their own a socially desirable level of service with specific pricing and quality requirements: cheap electricity for vulnerable social groups; periodical collection and dispatch of post mail to and from any geographical point. Covering those 'public service requirements' exceeds marginal cost; there will be no supply to all unless the State undertakes those

---

[14] For instance, Regulation (EU) 2016/679 of the European Parliament and Council of 27 April 2016 (General Data Protection Regulation), was adopted to regulate and safeguard a modern public good: 'trust in the digital markets'.

[15] See Chapter 2, section 1.1.1 and Chapter 2, section 3.2.2.

[16] Or to sufficiently ensure the quality of the provided goods. *Acemoglu et al.* 2008.

[17] *Calabresi/Bobbitt* 1978.

activities or pays private providers for the excess costs. In the EU, this is mainly guaranteed through legislation on the 'universal' provision of services of general economic interest.[18]

In conclusion, public goods constitute the field in which top-down intervention is most justified. Non-consensual institutions are called upon to undertake a broader role: to supervise and regulate; sometimes directly to provide; in all circumstances, to be the guarantor of those goods. It would not be an exaggeration to say that the greatest benefit of State action – the positive answer to the question 'why is there a Demos and public law?'– is found in the area of public goods.[19] Even general interest – being the sum of multiple, private and collective, needs – is a public good; its effective protection makes the existence and exercise of public authority necessary.[20]

1.2 The Privileges of the Demos

We have examined the problems of the Agora that made the Demos necessary. But why is the latter more suitable to engage with these problems? The answer to that question relies on a series of the Demos' privileges, namely, to intervene centrally (section 2.1), unilaterally (section 2.2) and uninterruptedly (section 2.3), possessing the monopoly of public power (section 2.4). Those privileges are better used in the context of democratic liberalism (section 2.5).

1.2.1 Centralised intervention

In contrast to markets, which operate in a decentralised and fragmentary way, public regulation has the means to intervene in a consolidated and uniform manner. Central co-ordination is a significant factor in reducing transaction costs, in cases where the deficiencies of rational choice fail to lead to the most efficient solutions. Let's take food safety legislation as an example. By drafting an exhaustive list of hazardous substances, requiring that the content of manufactured foods is clearly written on their package or imposing heavy penalties and increased civil liability for offenders, public intervention reduces many transaction costs. It eliminates the information deficit for consumers and the moral hazard for producers. It renders unnecessary countless negotiations in which the parties are not subject to conditions of equality (consumer/producer). It reduces disputes as to food quality, while rendering their resolution easier. Furthermore, it enhances legal certainty and trust in the food market, two public goods that would be at direct risk from the opportunistic behaviour

---

18 See Chapter 7, section 2.2 and *Szyszczak/Van de Gronden* 2013.
19 *Cowen* 1992.
20 *Napolitano* 2007.

of irresponsible food producers. It also deals with negative externalities in specific transactions, such as those between the farmer delivering the raw material and the producer of the foodstuff. Those two would otherwise have no regard for the consumer. Finally, a central public policy for food safety increases efficiency in globalised food markets. This is the reason why national legislation has partially given way to European food safety regulations[21] and now to a global *Codex Alimentarius*, prepared by the WTO.[22]

Food safety is not the only case in which public policy is beneficial. Similar regulatory interventions are in place for almost all human activities. We have discussed land and town planning in the example of the Coase theorem:[23] without a public eye in such a sensitive field of collective action, the confectioner and the doctor would still be in dispute. This indicates how crucial State action is in reducing transaction costs. In general, rational choice involves a fundamental defect: the inability to achieve welfare effectively in the exclusively decentralised system of 'anarchist' horizontal transactions. This shortcoming can be countered only by the precisely opposite method, that of central public action.

1.2.2 Unilateral and compulsory intervention

To be effective and efficient, the Demos' action requires another element: the authority unilaterally to enforce choices made centrally. The interrelation between these two parameters is almost self-evident. Uniform compliance cannot be left to the consent of those to whom the public decision is addressed. It cannot but have a compulsory character, forcing everybody to desist from behaviours that they would opportunistically advance themselves. *State action efficiency is interwoven with sovereignty*. Sovereignty is the organisational antidote so that individual choices do not create the social 'jungle' described by Thomas Hobbes[24] and by Hollywood in the *Mad Max* movies – a world of constant warfare of all against all, the prize being narrow personal interest.

Sovereignty also includes compulsory collection of resources in favour of public institutions. Beyond direct and indirect taxes, a feature of sovereignty is the acquisition and exploitation of resources by the Demos: specific real estate assets (public buildings, monuments); elements of the land (forests, coastal zones); the sub-soil (mines) and the sea (such as zones of exclusive exploitation); management of limited resources (radiofrequency spectrum). The crea-

---

[21] See Regulation (EC) No 178/2002 of the European Parliament and of the Council of 28 January 2002, establishing the European Food Safety Authority and procedures in matters of food safety (OJ L 31, 1.2.2002, pp.1–24); *Schild* 2013.

[22] *Bavorová et al.* 2014.

[23] See Chapter 3, section 13.3.

[24] *Hobbes* 1651 (1982).

tion of wealth is necessary to create the institutional edifice of the Demos and to fund unilateral actions. It renders possible the planning and imposition of central policies as well as the production of public goods.

In sum, the efficiency of public institutions is directly interrelated with their power to impose themselves without consensus and unilaterally. Conversely, any sovereignty blind spots are directly translated into severe regulatory failures. As we realised recently, the controversies as to whether the US President or the Governor of New York State was responsible for applying and lifting the coronavirus curfew were detrimental to the fight against the disease.

1.2.3 The constant and uninterrupted nature of public intervention

Social welfare needs to be *continuous* and *sustainable.* The spontaneous operation of the markets serves but does not ensure welfare at any given moment. Private economy is obstructed by cyclical crises and uncertainty. Without public intervention, there will be 'welfare losers', whether occasionally or in the long term – for example in the case of the unemployed at times of economic recession, or that of those who will be left for a certain period without electricity or means of transport if providers go bankrupt. Coming generations may also have the 'misfortune' of being born a few years after their predecessors have consumed all non-renewable resources. Public institutions possess the antidote to these problems: their capacity to intervene at all times, preventively or curatively, so that human needs are covered in a constant and sustainable manner. In this way, social justice goals are served consistently rather than only occasionally. The continuity of the Demos is the most effective means for reducing the cost generated by the inherent uncertainty of human life. Continental public law knows that already: the uninterrupted provision of public services constitutes a general principle of French administrative law (*principe de continuité des services publics*). The State may also act as a 'saviour' (*Stato-salvatore*, according to Giulio Napolitano)[25] in situations of severe market failures putting welfare at stake. It did so in several countries during the past decade to redress issues in the financial sector.[26] The

---

[25] *Napolitano* 2008, 2010.

[26] Such as the US, Ireland, Greece or Cyprus. The deficient operation of the banks (also due to ineffective supervision) rendered their re-capitalisation necessary to avert the collapse of the financial system. This measure was not instigated by the need to save their shareholders. In the name of continuity and social welfare, it aimed to avoid a period of anarchy and panic until the appearance of new and robust banking institutions.

EU Commission followed a similar rationale in its 2020 decisions to allow extended state aid policies in the sectors more affected by the pandemic.[27]

1.2.4 Public authority as a natural monopoly

To be effective, the power of public institutions must also be *exclusive*. *Sovereignty has the characteristics of a natural monopoly*. It allows the State to enable the optimum allocation of resources only when it is not exposed to the destructive competition of other sources of similar power (organised crime, paramilitary political organisations). Otherwise, there cannot be central decisions and policies that apply unilaterally and over time. The monopoly of sovereignty offers efficiency to the entity that enjoys it via the economies of scale it attains. Conversely, if such monopoly collapses, the benefits of public intervention, and so the *raison d'être* of the State, cease almost automatically. At this point, economic analysis meets the traditional definition of Max Weber: the State, in order to exist, must claim the monopoly on the legitimate use of violence within its territory.[28] Following the same line of thinking, institutional economics refer to failed States[29] to describe networks of non-consensual institutions which, having lost that crucial monopoly, are unable to enforce their rules consistently, or to provide basic goods and services to their citizens; at the same time they are exposed to grave problems, such as crime, corruption, stifling bureaucracy and ineffective justice.

Nowadays, we are witnessing a retreat of State sovereignty, mainly in favour of supranational organisations (EU, WTO). Nevertheless, this does not mean that public authority – the ability of non-consensual institutions to enforce their decisions on private individuals – has lost its monopolistic character. Quite the opposite: it remains a monopoly even when allocated among several institutions within or outside the State. Despite any rivalries they may have, these entities operate as a collective monopoly with limited internal competition. Any conflicts over power, beyond reducing the efficiency of public action, are by nature temporary: sooner or later they lead to some new status of sovereignty, monistic or pluralistic.

It is worth recalling the *bras de fer* between national constitutional courts and the Court of Justice of the EU regarding the supremacy of their respective legal orders.[30] Sometimes it appeared as a *dialogue de sourds* with directly

---

[27] Communication from the Commission Temporary Framework for state aid measures to support the economy in the current COVID-19 outbreak 2020/C 91 I/01, C/2020/1863 (OJ 911, 20.3.2020).

[28] *Weber* 1919 (1965).

[29] See Chapter 1, section 2.2.1; *Acemoglu/Robinson* 2012.

[30] See the CJEU judgment in case 11/70 – *Internationale Handelsgesellschaft* (1970) and the 'Solange I' judgment of the German Federal Constitutional Court (BVerfGE [1974] 34, 269). *Callejon* 2012.

opposite declarations on sovereignty. However, behind the scenes there has always been mutual tolerance and awareness that an open war would be much more harmful. Despite their differences, both the European and the national legal orders prefer jointly to preserve and apply the monopoly of public force on their citizens; if not as a 'monopoly of one', then in the form of a 'sovereignty cartel'. The efforts to record in the Treaty of Lisbon the exclusive and shared competences of the EU (vis-à-vis those of the member states) as clearly as possible serve precisely that need: to avoid authority conflicts that economic theory would describe as destructive competition. Such effort was undermined by the May 2020 judgment of the German Constitutional Court (*Bundesverfassungsgericht*) that expressly challenged the exclusive authority of the CJEU to interpret the EU Treaties.[31] Nevertheless, even this conflict, despite the major disturbances caused, does not reverse the monopoly of public power as such; it is rather an attempt to redistribute the respective roles within the said monopoly at a European level.

By treating public authority and enforcement as a natural monopoly, economic analysis and game theory offer their own explanation for the creation of the Demos.[32] The State can be seen as the outcome of a co-operative game. People adhere voluntarily to it, by signing a social contract. They aim to confront problems of collective action and other shortcomings of their consensual institutions. This is how democratic constitutions are born.[33] But there is a less 'romantic' version, as well. The State is seen as the outcome of consecutive dominance games between powerful and weak players, in which the former exercise violence over the latter. From a certain point onwards, the most rational strategy in such games is the periodic payment of ransom by the weaker players to those who hold power, in exchange for internal and external peace – as the Athenians paid the Cretans before Theseus slew the Minotaur, or as the allies paid the Athenians at Delos at the time of Athenian hegemony;

---

[31] *BVerfG*, Judgment of the Second Senate of 05 May 2020 – 2 BvR 859/15 – paras 1–237, on the conformity of the Public Sector Purchase Programme (PSPP) of the European Central Bank (ECB) with the provisions of art. 123 TFEU. Since 2015, the ECB has launched a vast programme to buy national public bonds as a means to indirectly support the economies of the member states. According to the *BVerfG*, such policy (relying also on funds coming from the German Federal Bank) violates the strict letter of art. 123 TFEU, prohibiting the ECB from financing national institutions. To arrive at that conclusion, the German court set aside a previous, contrary judgment of the CJEU on the exact same matter (judgment of 11.12.2018, C-493/17, *Weiss and others*). The national judges qualified the CJEU judgment as *ultra vires* and ignored art. 19 TEU which assigns to the CJEU 'the interpretation and application of the Treaties'.

[32] *Mackaay/Rousseau* 2008.139; *De Jasay* 1998; *Hardin* 1997; *Van Creveld* 1999; *Aguilera-Barchet* 2015; *Barzel* 2002.

[33] *Gordon* 1999.

or as several States buy arms from the USA or Russia to obtain geopolitical support. By paying ransoms, the weak preserve part of their wealth; the part that the power-holders allow them to retain so they can pay again next year. Conversely, the powerful players choose not to excessively exploit their dominance over the weak. By doing so, they may collect several ransoms over the years and do not make it preferable for the weak to replace them with another 'ransom collector'. The State, which gradually became the carrier of enforcement authority, is just that: an entrenched ransom collector – or, to use Mancur Olson's expression,[34] the 'permanent bandit' that provides protection against all sorts of roving bandits. The latter would otherwise have the incentive to plunder us completely, at a greater cost than if the State undertook this itself. Even if sometimes we consider the State as a robber, it always remains necessary.

In conclusion, the establishment of the Demos as a mechanism of monopolistic exercise of enforcement, irrespective of whether it is the result of consensus or compulsion, constitutes (up to a point) a Pareto optimal choice, both for the carriers of authority and for their subjects. Both are better off in the existence of the State than in its absence. This explains two things: first, the gradual prevalence of the State model to organise societies; second, the tendency to increase its power. In other words, it is more efficient for what we have called the Demos to exist than for it not to exist.[35] To be, rather than not to be.

1.2.5 The enhanced efficiency of liberal democracy

We just examined the reasons why public intervention may be beneficial. Those benefits are maximised for public institutions organised within a liberal and democratic political system. Institutional economics has shown that western societies that adopt the principles of liberal democracy achieve higher levels of prosperity. Similarly, there seems to be a close connection between 'western-style' legal orders and the better satisfaction of needs. Liberal democracy presents the following efficiency advantages compared to other political systems.[36]

First, it allows people to express their preferences through the election process. Democracy is a bottom-up mechanism, partially similar to the Agora. By contrast, authoritarian regimes suffer from increased information deficits; there are no voters to reveal what society really wants.

Second, democracy is more consensual than other political systems. Consent reduces policing and enforcement costs for public decisions. The latter are

---

34 *Olson* 1993.
35 *North* 2010.
36 *Olson* 1993; *Breton et al.* 2003; *Helliwell* 1994; *North/Thomas* 1973.

reached in the name of the sovereign People. Since they presumably express the will of the citizens, there is less opposition to compliance, and so less need to activate enforcement mechanisms. In authoritarian regimes, public enforcement is more costly and ineffective. There is a Robin Hood ready to resist the despotism of the Sheriff of Nottingham. What we call 'democratic legitimacy' in constitutional law is a crucial factor for increasing State (or EU) efficiency; it reduces the cost of their action.

Third, it turns freedom and other aspects of social welfare into fundamental rights. Therefore, it allows the holders of such rights to demand the proper use of public authority. By invoking 'individual' rights, they safeguard free choice, which is necessary for the optimum satisfaction of human needs, from the excesses of State interventionism. By referring to their 'social' rights, they may ask for the promotion of public policies against inequality and uncertainty. Making citizens active is, economically speaking, an effective means for improving the Demos. Those affected by public decisions have the incentive to gather information on the defects of such decisions and to demand that they be remedied. Conversely, the absence of a fundamental rights protection mechanism is equivalent to the lack of incentives for maximising State performance. It renders dictatorial regimes inefficient by nature.

Fourth, liberal democracy enjoys the decisive advantage that it encompasses institutional counterweights to the excessive concentration of power. It creates conditions of internal competition between the carriers of public authority (parliament, president, administration, justice) to avert abuses. 'Western' democracy is the only historical example in which over-concentration of public power has been successfully contained.[37] This explains its success and the gradual prevalence of that organisational model in the modern world.

Briefly, democratic liberalism is the *most efficient* among political systems. This does not mean, however, that it always functions efficiently. We will encounter some of its defects in examining the costs of public intervention.

2. THE COSTS OF PUBLIC INTERVENTION

Speaking of public intervention costs, it is useful to make the following distinction. There is the cost – we may call it 'justified' – corresponding to the unavoidable price of every action. If the State undertakes the provision of a public good, such as national defence or a road network, there will inevitably be an economic burden. This is equal to the optimum use of the resources required for that purpose: capital, infrastructure and manpower for protecting

[37] *Mackaay* 1997.

the frontiers or for building a new highway. Clearly, such a burden does not undermine the benefits of public action.

But this is not the only cost. There are other costs, which are less justified. They can make us wonder whether the operation of public institutions is indeed beneficial in certain cases. They arise from three main sources: the vertical and monopolistic structure of the Demos (section 2.1); the inherent shortcomings in reaching collective decisions (section 2.2); and an increased principal-agent problem (section 2.3).

2.1 Information Deficits and Monopolistic Inefficiencies

Public authorities have the monopoly to intervene vertically (top-down) into human affairs. Such action is necessary for redressing some of the Agora's failures. But it comes with serious side effects. It suffers from a double deficit: that of the necessary information (section 2.1.1) and of the necessary incentives (section 2.1.2) that prevent the Demos from acting efficiently.

2.1.1 The information deficit of public intervention

Citizens often complain that 'the State does not feel them'. It passes laws and sets restrictions (administrative formalities, tax burdens) without understanding what is really at stake. If we disregard the dishonest grumbling of those who want the field to be unregulated so they can exploit it, the above discontent has more than a grain of truth. Unfortunately, this defect is always present when a decision is reached and implemented in a *top-down* context. It is a necessary evil due to public intervention being exercised from above.

The explanation of this problem lies in the inability of those who decide vertically to collect and process the information that will allow them to advance the optimum allocation of resources. This information is available at the base of the pyramid; it is not held by the regulator, but by his addressees. It is created and disseminated spontaneously in horizontal relationships and transactions. Even the simplest paternalistic structures – the family, or a small business – lack this advantage: nobody is omniscient and all-knowing to perfectly govern the fortunes of others. The information deficit is multiplied in complex mechanisms, such as the modern State. Its democratic structure reduces this defect, though it doesn't eradicate it completely.[38]

Pointing out the informational problem does not aim at rejecting public regulation altogether. We are bound to live with the vertical intervention of

[38] This is the reason why authoritarian regimes deploy 'Big Brother' mechanisms to gather information and to spy upon their subjects. Unfortunately, information technology assists them in that heinous action.

the Demos and with the cost of deficient information which beleaguers such action. But those costs should not be inflated without reason, as did traditional administrative law, which established non-transparent and non-participatory procedures. Secrecy always aggravates information deficits. On the contrary, transparency and participation of private individuals at the decision-making process are crucial for reducing the information deficit that is inherent in public action.[39] In the US, the Sunshine Act introduced in the mid-1970s[40] used those tools to enhance the efficiency of the administrative system. In Europe, similar instruments – public consultation is one of them – serve the same objective.[41]

Moreover, top-down action taken by non-consensual institutions should be restricted only to fields where it is inevitable; it should also take forms that are less exposed to information deficits. The latter are reduced if private individuals are allowed margins of self-action – let's not forget that people often know best what concerns them directly. Involving private parties in public regulation tasks may have various aspects, including the partial transfer of administrative supervision into their hands: to the (private) accountant who files the income tax statement, or to the civil engineer who signs the construction plans instead of a building permit. It may also lead to less rigid and exhaustive norms, leaving room for horizontal transactions.[42] Let's come back again to the example used by Coase for his theorem. Noise pollution disputes between neighbours are suitable for consensual resolution:[43] private individuals may agree on higher noise levels than those standardised by the State.

The Kyoto Protocol against global warming was a notable example of a combination of public regulation[44] and private initiative, taken by the international community.[45] Instead of establishing a maximum level of greenhouse gas emissions for all industrial activities (and entrusting States with the unfeasible task of enforcing it) something more enterprising was preferred: to award gas emission rights to businesses. In other words, the industries were given 'rights to pollute' and the option of reselling such rights or buying more, depending on their needs. This way, the main ecological objective of gradually limiting overall emissions at a global scale is served. Concurrently, the secondary allocation of those rights is left to the market, which possesses the

---

39 *Hood/Heald* 2006.
40 *Government in the Sunshine Act* (1976), *U.S.C.* § 552b.
41 See Chapter 8, section 2.4.
42 *Coglianese/Mendelson* 2010.
43 See Chapter 3, section 1.3.3.
44 For market-based environmental regulation, *Montero* 1999, 2005.
45 *Albrecht et al.* 2014; *Weishaar* 2016; *Helm/Hepburn* 2011; *Munro* 2018; *Woerdman et al.* 2008; *Endres/Ohl* 2005. More broadly on environmental economics, *Swanson* 2002; *Endres/Radke* 2012; *Buchholz/Rübbelke* 2019.

information for doing so more efficiently. Gathering the necessary information is not independent of the motive one has to obtain it and use it efficiently.

2.1.2 Public institutions as an inefficient monopoly

Sovereignty is inconceivable without power monopoly. The monopolistic rationale is omnipresent in public law. First, as against private individuals: they are not allowed to 'compete' with public bodies in matters involving the use of State authority. Second, as a means for protecting the sovereignty of the legal order against external centres of power: every State claims the exclusive power to enforce legality within its borders. Third, as a means to avoid internal destructive competition: State authorities are most often granted exclusive and not shared powers to avoid overlaps and forum shopping. Fourth, in many countries (Greece, Italy and France are among them) it is even in the genes of administrative bureaucracy. Public servants enjoy 'permanent' careers; they acquire an exclusive right over the job they hold, until retirement.

The monopolistic nature of public action is, therefore, evident; the inefficiencies that accompany it are equally obvious. Non-consensual institutions display all the inherent impediments of a monopoly.[46] They have reduced access to required information, since they are not obligated to compete with others, or to listen to the needs of demand. Entrenched behind their authority, they have no incentive for improvement. A typical administrative agency does not start its day seeking ways in which to better satisfy the public; maladministration will not result in lost customers. As with all monopolies, it is not interested in innovation: the 'adaptability' of public services (*mutabilité des services publics*) is maybe a fundamental principle of administrative law, but not an operational necessity. The efficiency of public authorities remains limited. Even when they do serve the general interest, it is not with the minimum sacrifice of resources; it is with more personnel, capital and time than is 'normally' required. Administration often confuses efficiency with greater effort rather than optimal results; in economic terms, it maximises *input* and underrates *output*. This explains its tendency for gigantism.

The image of the unproductive State is familiar to all. However, it is not caused by the laziness or incompetence of the people that staff it. It is explained by its monopolistic structure. The same persons would operate much more productively under competitive conditions; conversely, they would equally lack incentives if they were employed in a private business holding exclusive rights (the only ship connecting a specific island). Since we cannot live in a 'non-monopolistic State', the problem is not susceptible to drastic remedies. But the cost of monopolistic inefficiency can be reduced. The solution lies in

---

[46] See Chapter 2, section 3.4.1.

the fundamental principles of subsidiarity and proportionality.[47] *Monopolistic public action shall be restricted only to the fields it is needed and up to the point it is necessary*. This goal can be pursued in two ways.

First, it is not always suitable to organise as monopolies activities that are not part of the core of the State, such as public utilities or merit goods. Their provision does not depend on the exercise of public authority. Therefore, it does not have to be assigned solely to State entities but can be open to competition. That is the point of *liberalisation*,[48] advanced by the EU in the sectors of energy, electronic communications or transport. It involves the creation, as far as possible, of regulated but competitive markets. The emergence of several providers reduces the inefficiencies of the pre-existing public monopolies. Liberalisation is an aspect of a broader restructuring, called *privatisation*,[49] where parts of State competences or assets are shifted to the private sector. Privatisation can assume various forms. It can be direct, by transferring the ownership and/or the management of an economic entity (mine, tourism infrastructure, public corporation) to private players; or *indirect*, as when the liberalisation of an economic sector opens up the field for other players apart from the State-owned provider. Indirect privatisation can also be achieved through public procurement and the assignment of State tasks (construction of a road, city cleaning services) to private contractors.[50]

Second, it is possible to create conditions of limited internal competition between public authorities, even when the activity does not pass into the hands of private business. The monopoly of sovereignty remains with the State, but within the latter, the subsidiary bodies and entities may compete among themselves. Internal competition gives rise to complex yet interesting questions. This subject is familiar to constitutional law through the separation of powers principle, which we shall discuss in a later chapter.[51] Within administrative structures, a 'competition rationale' can be pursued by making public servants compete for promotion to a managerial position. It may also be introduced for administrative units operating at the same level; for example, when public funds for education and health are allocated among public universities or hospitals on the basis of their performance. Public resources are limited; channelling them to those that attain predetermined targets increases efficiency.[52] Another solution for enhancing competitivity is to grant a more active role to

---

47 See Chapter 5, section 1.1 and Chapter 5, section 1.2.

48 *Geradin* 2000; *Marcou/Moderne* 2005; *Laffont/Tirole* 2001; *Joskow* 1996; *Prosser* 1997, 1999.

49 *Prosser* 2000; *Cragg/Dyck* 2003; *Bergstrom et al.* 1986.

50 See Chapter 8, section 1.6.

51 See Chapter 6, section 2.2.

52 *Biber* 2008. It could also reduce corruption: *Di Gioacchino/Franzini* 2008.

citizens – to allow them to choose among universities or hospitals, the region where they will start a business, even the public authority that will grant them the necessary permits or the court that will resolve a dispute. Recognising individuals' margins for rational choice – so that they can determine, up to a point, which public entity they are subject to – creates a 'market model' for non-consensual institutions and reduces their monopolistic inefficiency.[53]

The above approach obviously contradicts the organisational paradigm described by traditional public law. There, competences among administrative authorities were granted on an exclusive and non-negotiable basis. Yet, this is not totally inconceivable, especially in the globalisation era that has weakened States' authority over people and economic entities. If sovereign States[54] are forced to compete among themselves to attract private individuals into their legal orders, this can also be applied within the Demos. Such initiatives face strong resistance, since no monopoly wishes to evolve. For instance, internal evaluation of administrative authorities is often seen as an evil by staff.

2.2 Failures in Reaching Collective Decisions Efficiently

Let's return to our Greek summer tale[55] that illustrated the difficulties in reaching collective decisions. It is not just the three friends who cannot choose which Aegean island to visit. The problem is much bigger, and appears when more than two persons are invited to select among more than two options. For constitutional law, it is a real nightmare. Those who decide are not three friends with similar education and age. They are millions of completely different citizens. Even their representatives are numerous: members of parliament, cabinet members, the president. And what is at stake is incomparably more important than a holiday destination.

It is time to face it, then. *The democratic system is exposed to serious problems in reaching collective decisions*. Those problems need to be brought to light, since all main public choices in our modern political systems are the fruit of a strategic game, called representative democracy.[56] In the election process, the visible participants are two: *citizens/voters* and *candidates/elected officials*

---

[53] According to the model introduced by *Tiebout* 1956.

[54] And non-sovereign, as well. In the US, the states of the Union compete among themselves in attracting investments by the ways in which they exercise public authority (taxation, red tape, economic and social regulation).

[55] See Chapter 2, section 3.4.1.

[56] This is what the Public Choice school does, by questioning some of the axiomatic assumptions of public law. In the light of Arrow's theorem, it considers the procedures for reaching public decisions as games. See Chapter 3, section 2.1.2 and the essays edited by *Congleton et al.* 2019a, 2019b.

(section 2.2.1). In real political life, there is an additional player, *pressure groups*, which try to influence collective decisions (section 2.2.2). These three players determine, to a large extent, the features of public action and the content of the general interest. The latter is not conceived immaculately, as we naively used to believe. There is much 'dirt' in the process of reaching collective decisions; or, as economists call it, high transaction costs (section 2.2.3).

2.2.1 Voters and candidates: the true story

Economic analysis reveals an inconvenient truth, which is how marginal the role of the citizen/voter is in the electoral process.[57] Citizens are called upon to resolve many and complex dilemmas that affect all aspects of welfare depending on elections. They are (indirectly) asked to vote on issues such as the levels of taxation or the amount of their pension, the regulatory framework for their profession, the value of their property, immigration, the creation of a European or an international free trade zone; in countries like Greece and Italy, even on the future of a bankrupt football club. Those questions may have multiple answers, often contrary to their personal preferences. The great number of choices to be made creates an additional impediment: it is difficult for the voter to be informed on all matters. At the same time, the significance of one's vote – just one, among many others – is inversely proportionate to the cost of acquiring information and responsibly participating in the process.

Furthermore, elections in representative democracy ask those questions in a rather tricky manner. They do not reveal the cardinal or even the ordinal preferences of the voters on such a variety of conflicting matters. There are others, the elected candidates, who will decipher and decide upon these preferences. The voters are not invited to give a clear mandate on how exactly a financial crisis shall be handled. Do they prefer tax increases rather than pension cuts, and up to which point? They only vote on who will supply these answers. Apart from referenda,[58] The People are called to choose persons or parties; the latter will handle, on a more or less *carte blanche* basis, all of the 'agenda'.

Therefore, it is not irrational to select candidates without much thought. This behaviour is called the *voter's rational ignorance*.[59] Such apathy reduces the efficiency of the electoral process. The result of the elections is not sufficiently representative. It does not reveal the real preferences of the voters. Such conscious ignorance in modern democracies explains the low rates of turnout and the success of candidates that enjoy superficial recognition (former actors and

---

[57] *Mackaay/Rousseau* 2008.147; *Napel* 2019.

[58] A process that is not without serious problems. See Chapter 6, section 2.1.1.

[59] *Caplan* 2007; *Downs* 1957; *Ferejohn/Fiorina* 1974; *Aldrich* 1997; *Bowler/Nicholson* 2019 and *Somin* 2019.

athletes) or play on the emotions of voters (populists). This phenomenon is aggravated by constitutional rules, which allow politicians not to be bound by their mandate nor to be impeached for violating their promises.

The paradoxes of the electoral mechanism also affect the strategies of the candidates.[60] As in purely economic relationships, where demand shapes supply, the expected stance of the voters directs the behaviour of the candidates in the political arena. This is so both when they ask for our votes and when they exercise public duties. For economic analysis, the performance of public institutions led by elected persons depends considerably on the aspirations of the latter. Prevalent among these aspirations, despite any value-based considerations (patriotism and ideology, public image, sense of giving), is that of re-election. There are more or less 'cynical' ways to describe the political game. According to the most extreme description, *homo politicus* is like the same old *homo oeconomicus*: a selfish monomaniac. Politics are markets:[61] a plethora of vote-seeking and power-broking transactions via the promise or the implementation of policies and programmes, as in the TV series *House of Cards*. The transactions concern public actions, whose cost falls upon the public treasury. They are conducted on two levels: vertically, between voters and candidates; horizontally, between elected officials, who agree mutually to support or blackball policies (*logrolling* is the American term for that): I will vote for your new tax law if the shipyard in my constituency remains open.[62]

The above description is maybe too schematic and nihilistic. But it does reflect aspects of the truth. Empirical research has recorded some characteristic behavioural patterns by elected officials, which indicate that they reach decisions based on their chances of re-election rather than on the common interest. First is the short-sighted prioritisation of public choices that offer immediate advantages to voters:[63] politicians may prefer to finance a needless infrastructure project (such as a new highway) instead of actions that would be beneficial in the long term (such as improving the quality of the environment). Similarly, there is a preference for collective decisions, in which the benefits are more visible than the costs. Who pays the ferryman (the long-term costs) remains unclear. An example is granting subsidies in favour of professional groups (such as a tax exemption to lawyers), which cost the consumers and taxpayers incur without realising.[64] *Myopic choices* together with the concealment of their costs explain, to a large extent, the financial collapse of some countries in the European South. In the mid-1980s, it became easier for those States to

---

60 *Mackaay/Rousseau* 2008.149; *Napolitano/Abrescia* 2009.105, 163.
61 *Parisi* 1997.
62 *McGann* 2019.
63 *Garrett* 1996.
64 *Friedman/Friedman* 1990; *Buchanan* 1984b.

borrow money in the international market. The loans were used for expensive, popular but useless policies (subsidies, costly infrastructures, organising the Athens 2004 Olympic Games) with immediate political benefits. The cost was carried forward to future budgets and soon became unsustainable. Such choices may be democratically approved but can hardly be considered efficient for promoting social welfare.

In conclusion, sometimes the cost of a public policy burdens the community as a whole, while its benefits are enjoyed by the few. It doesn't look very 'democratic', does it?

2.2.2 The power of minorities in the democratic process: pressure groups and swing/median voters

The concentration of the benefits among minorities, and the diffusion of the costs among the silent and apathetic majority, is also related to pressure groups.[65] Since individuals are incapable of exerting influence by means of their one vote, they do so by lobbying – it's a perfectly rational choice. By acting collectively, behind the scenes and outside the election process, they increase their chances of favourable collective decisions. The more compact a pressure group is as to its objectives, the more effectively it can advance its agenda. Sometimes, lobbies with few members are more solid and tenacious.[66] However, even more numerous groups can establish a compact front in exceptional cases: the Church and the 'moral majority' for ambiguous social issues (euthanasia); trade unions of public servants for salary matters.

The lobbies' power to influence collective decisions is disproportionately large and it may often be inversely proportional to their representation in society or the economy. Choices made in the name of the general interest may serve minorities' agendas.[67] These groups claim unjustified benefits by exploiting the ignorance of the general public together with the ability of candidates to conceal costs. This phenomenon is called *rent seeking*[68] and can take several forms: from passing a tax exemption or awarding a subsidy to extending the hunting season despite environmental concerns (hunters are

---

[65] *Becker* 1983, 1985; *Olson* 2002 (1965); *Niskanen* 1994; *Van Winden* 2004; *Croley* 2010.

[66] Let's take the case of subsidies and tax exemptions for farmers as an example. Such preferential treatment is more often recorded in States with a small farming sector instead of traditionally agricultural countries. The large number of farmer-voters does not make it easier for them to advance their demands. This profession is better able to defend its interests in non-agricultural countries, precisely because it is a minority.

[67] For example, when passing environmental legislation: *Farber* 1992a.

[68] See Chapter 3, section 2.1.2 and *Rowley et al.* 1988; *Congleton/Hillman* 2015; *Hillman/Van Long* 2019; *Del Rosal* 2019.

one of the most compact pressure groups). Not all privileges constitute rents; incentives in favour of ethnic or racial minorities in education are socially desirable forms of positive action to fight discrimination. Unfortunately, the opposite may also be the case. If so, the social surplus is not diffused fairly; it ends up in the pockets of pressure group members. Such preferential treatment is inefficient because it would not be possible in an open market. No one would agree to pay dockworkers a fixed sum for every shipment even without using their services; such obligation needs to be imposed though a public decision in exchange for political backup (votes). Pressure groups and rent seeking are crucial cost factors for State interventionism and public law.[69]

Pressure groups increase their impact by being the *swing voters*: those who determine the outcome of elections by switching political parties. Swing votes are also found in those among the electorate who share more moderate ideological views – in other words, at the centre of the political spectrum. This explains why the biggest parties usually tend to converge towards what is called the 'centre' in politics, to voters with less strongly weighted preferences and who are more likely to change sides. In public economics, this phenomenon is known as the *median voter theorem.*[70] Therefore, the segment of the electorate comprising these median voters exerts a disproportionate influence on public policies. This way, the equality of votes constitutional principle loses a great part of its practical value. There is equality in law, yet not in real political life. But as we just mentioned, swing votes are not just those of 'the centre'. The outcome of the elections may be determined by other compact groups, those prepared to choose candidates on the basis of an issue which is highly important for them: the relationship between the Church and the State, national currency or euro, Brexit or non-Brexit. The essence remains the same: *public policy is often shaped by minorities*.

2.2.3 Collective decisions: a product with high transaction costs

The vicissitudes of the election process offer food for thought. As proven by Arrow's theorem,[71] there is no democratic mechanism that faithfully reflects the real preferences of every citizen. Therefore, there is no perfect way to determine social welfare 'representatively', so that it fully corresponds to

---

[69] It has been argued that the strikingly fast recovery of economic growth in Japan and Germany after the destruction they had suffered in 1945 can be explained by the absence of rent seeking during that period. Pressure groups (industrial lobbies, cartels, syndicalism) were eliminated after the military defeat. The war played the role of a grave but not lethal disease; it almost killed the patient but managed to exterminate the parasites sucking his blood. *Olson* 1982.

[70] *Congleton* 2004; *Romer/Rosenthal* 1979.

[71] See Chapter 2, section 3.3.3.

individual choices. Public authorities intervene in social or economic matters by applying democratically reached decisions; but the latter are far from being the optimal homogenisation of specific interests. Even when they record the will of the many, they may establish a 'tyranny of the majority', as named by Alexis de Tocqueville – to violate fundamental preferences of individuals for specific goods or values (life, dignity, freedom of expression, property). Something even worse is also possible: public decisions may even fail to reflect the will of the majority, but rather advance the agenda of several minorities, to favour a spectrum of private interests to the detriment of the common good. The axiom of continental public law, which identifies democratically reached decisions with the general interest, is proved to be fictional. The desires of the many may not be represented – rather, precisely the opposite may occur.

Beyond being 'representationally imperfect', those decisions also prove costly.[72] The democratic process involves transactions of all kinds: between voters and candidates at the stage of the elections; between elected officials in the corridors of parliament; between politicians and lobbyists; between the federal authorities and the States in the US, or between EU institutions and member states. Those transactions can be transparent or concealed, involving two or more sides, having one or several objects. The more the transactions increase, the more vulnerable national sovereignty is to external pressure – remember the endless negotiations about the Greek debt and Brexit. To put it more generally, public choices (decisions) incur high costs, especially when they are the result of many transactions. We saw this during the coronavirus pandemic. Legal orders where public decisions are the fruit of more complex political transactions came up with less efficient choices, doing too little, too late. This explains, to a certain extent, why Greece, a unitary State with few veto players, reacted more successfully (in the first phase of the pandemic) than richer and more advanced systems, such as the EU, the US and Italy. Those costs expose the naivety of traditional public law. They show that choices made by bodies enjoying democratic legitimacy are the product of bargaining. This makes them less efficient. Sometimes, a despotic State may act more promptly, as China (apparently) did regarding the imposition of confinement measures to block the expansion of the pandemic. Such 'authoritarian paradox' shall not make us question the virtues of liberal democracy, which, as we stated some pages above,[73] is a far better system for ensuring welfare. But we need to understand that *the democratic legitimacy of a public decision does not ensure its quality nor its efficiency*. Sometimes it is preferable for some

---

[72] *Napolitano/Abrescia* 2009.173; *Breton* 1974; *Wagner* 1989; *Wood/Bohte* 2004.
[73] See Chapter 4, section 1.2.5.

decisions not to be reached by politicians but rather by impartial technocrats. We shall return to this question later, in Chapters 6 and 8.

How bad are things for good old democracy and constitutional law? Fortunately, the situation is less tragic than the picture often presented by the Public Choice school. Yes, the democratic process is to a certain extent unable genuinely to reflect the general interest in collective decisions. Yes, the latter are encumbered by numerous, various and costly transactions. However, at the same time, these distortions do not nullify the capability of democratic institutions to make choices that serve social welfare rather than the cynicism of those formulating them. Otherwise, policies such as fighting global warming, or the promotion of culture, would have no chance at all in Europe. This is not the case.[74] The explanation probably lies in human nature itself. *Homo oeconomicus* does not behave as a person – a 'rational idiot', in the words of Amartya Sen[75] – who acts based only on the satisfaction of his needs at the lowest price. Human motives are usually much more complex, even when not entirely rational. Similarly, *homo politicus* (voter, candidate, lobbyist) does not act with absolute cynicism and selfishness; at least not always. This does not mean that we may remain naïve, as public law did for many years. We can no longer ignore the mechanical defects of reaching collective decisions.[76] Seeking a better version of the democratic State requires its realistic evaluation.

2.3 Public Institutions and the Principal-Agent Problem

In Carlo Goldoni's comedy *The Servant of Two Masters* (1746), the main hero is Truffaldino, who first serves the heroine, then her lover. Double agent? Not by any means: by acting as servant to both, Truffaldino tries to fill his constantly empty belly – to look after his own interests.

The principal-agent problem[77] will exist as long as there are principals and agents. Traditional public law ignores this self-evident truth, even though it was established to regulate the action of various (public) agents. According to our constitutions, members of parliament 'represent' The People or The Nation. The term 'minister' is a synonym for 'servant'. The administration provides public 'services' via agents, who receive orders and implement them. Public law in Europe has the tendency to disregard this problem. It presumes that both politicians and administrative officials behave selflessly; that they

---

74 *Wittman* 1995; *Mashaw* 2010.
75 *Sen* 1977.
76 *Acemoglu/Robinson* 2006.
77 See Chapter 2, section 3.2.3.

faithfully respect the general interest, as sailors do when following a route on a nautical chart. In law, this route is drawn in the constitutional map and defined by the lawmaker. The government (the captain of the ship) and the administration (the crew) just follow it. None of them is supposed to look in other directions. But it is not so. The Demos is a ship that does not necessarily sail towards the 'Island of Social Welfare'. Almost everyone on this ship has the inclination not to promote the general interest, but rather to advance private aspirations.

It is not an exaggeration to consider the principal-agent problem as the most significant source of cost for non-consensual institutions. Economic analysis of law faces the crucial challenge of understanding and reducing it.[78]

2.3.1 A multi-layer problem

There are several layers of mandates and principal-agent relationships in a modern European State.

The first is between citizens and public institutions. On one hand, it links The People with the elected officials (MPs in the national and European parliaments; the president in presidential systems). This direct 'mandate agreement' is provided for by the constitution. On the other hand, citizens are (to some extent) the principals of the administrative authorities. The latter bear the duty to execute public policies established on behalf of the voters and following their vote.

Second, in parliamentary systems (UK, Germany, the Netherlands, Greece), the parliament is the principal of the government. The latter is empowered to apply the laws passed by the former. Constitutional provisions, such as the confidence vote and the ministers' political responsibility towards the parliament, are tools for dealing with principal-agent issues. The situation is different in presidential systems (USA, France). The president bears also a direct mandate from The People, making the relevant political relationships far more complex.

Third, the next principal-agent layer connects the lawmaker and the government, on the one side, with the administrative authorities, on the other. MPs and ministers (together with the president, in presidential systems) define strategic public choices and appoint administrative bodies to implement them. Their re-election as 'political principals' of the Demos depends on the successful performance of their 'administrative agents'. If the latter

---

[78] On the principal-agent problem, see *Laffont/Martimort* 2002; *Napolitano/Abrescia* 2009.203; *Maskin/Tirole* 1990; *Gailmard* 2010; *Leruth/Paul* 2007; *Moe* 2006; *Kalt/Zupan* 1990; *Posner* 1972; *Posner* 2001; *Williamson* 1996, 1999; *Smith/Otto* 2011; *Dellis* 2019.

prove ineffective or advance their own preferences, politicians are doubly exposed – both as direct principals of the administration and in their capacity as middlemen, acting on behalf of their voters. Parliamentary systems try to resolve this problem in two ways. The first is by instituting a direct hierarchical relationship between the administration and the government. Ministers are the heads of the administrative pyramids which form the State. The second is by making ministers responsible before the parliament for all actions or omissions of the agencies falling under their supervision. In presidential systems, agency problems are more acute (which explains why US public law scholars insist on studying them).[79] The administration finds itself between two political principals: the president and the parliament. Each one independently represents The People and assigns duties to the administrative authorities. There is, therefore, *competition* between principals, increasing transaction costs. In parliamentary systems things are simpler. The political principal of the administration is essentially one: the government majority.

Fourth, principal-agent problems affect the efficient resolution of public law disputes. Administrative justice is a three-party game, between the courts and the two litigants (roughly, the private individual challenging a public decision and the authority supporting it). All three operate through agents. The private party is represented by an attorney. The administrative authority has two different agents: the person deciding on its behalf (minister, mayor) and its legal counsel. The competent court is composed of one or several persons, the judges. The latter decide 'in the name of' – and so, as representatives of – The People. Each of those agents does not always faithfully support the interests he represents (see Chapter 9). The lawyers may initiate or continue a lost cause. An indolent judge may delay in resolving a dispute crucial for the general interest.

Lastly, the principal-agent problem assumes another dimension in United Europe. The EU is the principal (via the European Commission as guarantor of the Treaties (17 TEU) and the Court of EU as their authentic interpreter (19 TEU)). Member states are the agents. They have the mission to correctly implement the EU's decisions in their domestic legal order. However, those agents are 'sovereign' States. It is not obvious how to make a sovereign institution act as a faithful agent of somebody else, and several EU rules try to reduce the extremely high agency costs between the Union and its member states.[80]

---

[79] See Chapter 3, section 2.2.3.

[80] Indicatively, the provisions establishing pecuniary sanctions against member states not complying with EU norms (article 260 TFEU), or CJEU case-law according to which the responsibility for the correct implementation of EU rules lies centrally with the member states (see, inter alia, the CJEU judgments in cases C-217/88, *Commission v Germany*, (1990) para. 26 and C-248/08, *Commission v Greece* (2009)

Imposing independent regulators in liberalised markets is one such, as we will see in Chapter 8.[81]

2.3.2 Agency cost within the Demos

Principal-agent costs can be divided into two categories, depending on whether losses are caused by political or by administrative institutions. The first fall under the scope of constitutional law; the second under that of administrative law.

2.3.2.1 Agency cost and political institutions

Agency cost incurred by the action of political institutions is further divided into three sub-categories, depending on whether it affects their relationship with the voter/principal,[82] transactions among themselves (parliament, government and the president), or their contacts with the administration. Empirical research reveals major differences between constitutional systems.[83] Those with more than one political institution directly elected by The People (a parliament composed of two chambers; the president) face higher costs. It is not obvious to institutions with increased political legitimacy to co-operate and to honour their mutual mandates. Their relationship with the administration is also complex. The latter is called to serve many masters claiming to express the will of The People. This competition complicates transactions between political and administrative authorities. Nevertheless, despite increased costs, such systems present an important advantage. They offer more leverage to voters, to make elected officials keep their promises. Let's take, for example, voters in the USA. If the president does not follow up on his or her commitments, voters may elect a hostile Congress at the mid-term elections. With its new composition, this body has the power to restrict, neutralise or even impeach the president. In other words, despite the cost it generates, competition between political institutions makes citizens more efficient principals.

Other constitutional orders involve a smaller number of political players. One-chamber parliamentary systems are less exposed to costly transactions between institutions exercising legislative, governmental and administrative functions. The government is entrusted with a clear mandate to execute the laws voted on by the parliament. To this end, it supervises the administration and monitors their implementation. There is no real competition between poli-

---

para. 56). By rendering immaterial the domestic authority accountable for violating EU norms, the CJEU reduced supervising costs that would arise if the contrary interpretation had prevailed.

81 See Chapter 8, section 1.5.

82 *Kalt/Zupan* 1990.

83 *Moe/Caldwell* 1994.

tical institutions (parliament and government), as there would be if there was a Senate or a directly elected president. We pointed out, some pages above, that this is preferable in times of crisis, since there are fewer transaction costs. However, in these systems, it is the citizens who incur, as principals, higher agency costs. They elect one compact and mighty agent, the governmental majority led by the prime minister. This player often forgets its promises soon after obtaining the mandate of The People.

European citizens suffer from additional principal-agent problems.[84] They are victims of what is called the EU's 'democratic deficit'.[85] They are not invited to choose the persons who hold the most crucial competences within the European Demos (the members of the Council and the Commission) in a direct way. The gap is even greater for EU decisions that the Council reaches by qualified majority:[86] the citizens' national representatives participating at the Council have no veto power to block them. Such deficit may be reduced only by extending the powers and the role of the European Parliament or by appointing the President of the European Commission through direct elections.

2.3.2.2 Agency cost in the administration: corruption, capture, drift and inertia

Politicians disregarding their voters' interests is outrageous. Yet, it is not the only form of agency cost in public action. The one caused by administrative authorities seems to be even worse. The administration is nothing but a gigantic system of agents.[87] When law entrusts an administrative authority with specific powers, it establishes a principal-agent relationship. Contrary to private law, this relationship is not the result of a consensual agreement between individuals; it is vertically imposed by sovereign authority. Yet, it is still a mandate to a representative, with all the relevant problems, on a much larger scale. Let's see why.

The administration involves an enormous number of persons. It consists of various structures in multiple layers, sometimes of labyrinthine form. All those bodies and individuals are recipients of public law mandates. The high volume and variety of agents is directly proportional to the cost of their supervision. It is almost impossible to make them accountable when powers (and responsibility) are diffused among central government, decentralised services, local authorities and independent agencies. The situation becomes even more complex when administrative bodies are not awarded clear competences.

---

84 *Faíña et al.* 2006.
85 *Lindseth* 1999; *Bowman* 2006; *Innerarity* 2015; *Sorace* 2018; *Kelemen* 2019.
86 See art. 7, 16 and 31.2 TEU.
87 *Posner* 1972; *Von Wangenheim* 2004.

Administrative agents are influenced by a great number of persons and factors, sometimes unofficial or unlawful. This is more frequent when powers are delegated to the lower levels of the administrative pyramid. The public servants at the end of the chain do not consider themselves accountable only to the national parliament, to the minister in charge or (more remotely) to EU institutions. They are also dependent on their superiors and exposed to the pressure of the citizens whom they serve. They are not immune to what the local community wants or to the interests of their colleagues and trade unions. Lastly, they also have their own needs in mind; to work less or to show results and get promoted. To put it simply, they do not function as robots, exercising their mandate automatically for the benefit of the public interest. In addition, they are not strictly and coherently controlled. Supervision is fragmented among several authorities: superiors, independent inspectors, the political head of the authority or the courts. Those players do not co-operate easily and have their own agendas. Ministers oversee the administration because they care to be re-elected or re-appointed; superiors, because it is part of their job; citizens bring cases to justice only if their interests are threatened.

Agency costs can even get worse. Administrative authorities often lack transparency. Obscure internal procedures generate information asymmetry. This factor increases principal-agent problems since it hinders accountability. Administrative officials act behind the scenes, in contrast to politicians, who are more open to the public. Furthermore, bureaucrats enjoy a more permanent and safer mandate. While politicians are exposed to periodical elections, members of the administration are subject to much less control. Their career is quite secure. Such guarantees protect them from political pressure but multiply moral hazards (and, therefore, agency costs).

Thus, an administration is fertile soil for principal-agent problems.[88] In opposition to traditional public law, we should not disregard the various personal motives of the individuals involved in administrative action:[89] less workload, better working conditions, higher remuneration, risk and accountability aversion, chances for promotion, ideological and political background (links with political parties, ecological movement, religious beliefs). But also, altruism, the need to help the weak, to make a better society, to find a meaningful role in life. All these motives, irrespective of their moral qualification as 'good' or 'bad', direct public servants towards courses other than just applying – neutrally and blindly – the legislation in force.

Agency cost does not only arise from personal aspirations. It is also attributed to the administrative institution itself, acting as an independent player.

---

[88] As all large-scale bureaucracies, *Tirole* 1986.
[89] *Simon* 1961; *Smith/Otto* 2011.

According to William Niskanen,[90] when performing their duties, administrative bodies do not just follow what is required by law. They seek to increase their leverage, their powers and their prestige.[91] It is a way for them to ask for a bigger budget and for more personnel. They try to get the most from their relationship with their political principals. Such a relationship is a *bilateral monopoly*: administrative authorities 'sell' administrative services to political institutions in conditions of mutual exclusivity; they do it in exchange for resources and power. In economic theory, bilateral monopolies (such as a married couple) are among the most stable and rigid, but less open to innovation and efficient bargaining. In this specific 'marriage', the administration appears to be in a stronger position than its political principals. Governments are bound to go through administrative bodies to execute public policies; they have no alternative but to depend on them. On the contrary, these bodies risk much less if they perform their duties with reduced passion and poor success. Or even when they commit 'infidelities', offering their services to other 'buyers'.

In this context, the equivalent of infidelity is administrative *corruption.*[92] Corrupted officials advance private agendas that are usually incompatible with the general interest. Corruption is an endemic cost in multi-member mechanisms with very high supervision costs. It flourishes in administrative sectors involving high economic stakes: taxation, the grant of subsidies, town planning public procurement.

Corruption is not the worst form of agency problem within the administration. *Regulatory capture*[93] is a more common and insidious pathology. Regulators are 'captured' when they cease to be immune to concealed influence or to pressure for promoting (private) interests. Though it leads to the same outcome as corruption or bribery – to public policies not serving the general interest – capture is not blatantly illegal. In its most 'innocent' form, it is due to the everyday relations between administrative bodies and regulated industries. The latter are gradually transformed into daily customers, who develop personal relations with administrative officials. These relations become even tighter through what is called 'revolving doors':[94] the same experts are recy-

---

[90] *Niskanen* 1971, 1994.

[91] Bureaucracy is itself a pressure group: *Dunleavy* 1991, 2019.

[92] *Rose-Ackerman* 1978; *Benson/Baden* 1985; *Di Gioacchino/Franzini* 2008; *Golden* 2018; *Aidt* 2019.

[93] We referred to regulatory capture when presenting George Stigler in Chapter 3, section 2.1.2. *Stigler* 1971, 1975; *Laffont/Tirole* 1991; *Carpenter/Moss* 2014; *Levine/Forrence* 1990; *Livermore/Revesz* 2013; *Novak* 2014; *Posner* 2014b; *Shapiro* 2012; *Shapiro/Steinzor* 2008; *Thaw* 2014.

[94] *Law/Long* 2012; *Zheng* 2015; *OECD Expert Group on Conflict of Interest* 2009.

cled under conflicting capacities – as representatives of the regulated firms and as employees or members of the regulator. Regulatory capture causes greater agency losses than corruption. It is harder to diagnose and to cure. It produces broader and long-term negative effects. Beyond awarding beneficial treatment to specific interests (as in the case of bribed officials), it is used by pressure groups to re-orientate or undermine public policies as a whole.

Lastly, there is another form of agency cost in everyday administrative action, more diffuse than corruption and capture: *drifting* and *slackness*. Absence of effective supervision, a large number of agents and their many levels, lack of transparency and selfish motives, are all factors that cause drifts in pursuing the general interest; orientation is easily lost. In addition, administrative authorities suffer from slackness in performing their duties: from a combination of inertia, apathy and poor efficiency.[95] If the Demos were a ship sailing for the 'Island of Social Welfare', it would often miss the harbour or arrive late, even when the captain and the crew were not corrupt or held hostage by private interests.

2.3.3 Public law: a mechanism to fight principal-agent problems

Economic theory has extensively studied the means to deal with agency costs.[96] The central idea is simple: such losses are reduced if the agent's interests come closer to those of the principal. To achieve this, both the carrot and the stick are needed.[97] On the one side, a series of incentives – financial or moral – to keep the representative on the right track: success fees for lawyers if they win a case; bonuses for executives depending on the company's performance. On the other, supervision, responsibility and sanctions for agents who take improper advantage of their mandate: accountability procedures, codes of ethics, increased civil and criminal liability (such as for company executives).

Unfortunately, the above solutions cannot be easily transposed into public law. Elected officials are given the broad and vague mandate to serve the public good. It is extremely complex (and, sometimes, risky) to provide for forms of responsibility other than purely political, namely their disapproval in the next elections. As for administrative institutions, the problem lies in the great number of agents involved. This makes it almost impossible to establish an efficient mechanism of incentives and counter-incentives based on the per-

---

95 *McNollgast* 1990.
96 *Tirole* 1986; *Maskin/Tirole* 1990; *Laffont/Martimort* 2002.
97 *Dari-Mattiacci/De Geest* 2017.

sonal assessment of public servants.[98] Despite the difficulty, public law shall focus on the principal-agent problem to make the Demos more efficient.[99]

[98] In addition, public servants enjoy a very protective regime. This may secure them against becoming politically dependent but it maximises agency cost (see Chapter 8, section 1.3). Such cost is lower in non-liberal systems. There, the administration is composed of persons close to the dictator or the only allowed party. They risk losing their job, their freedom or even their life if they do not toe the line. However, once again, agency losses are not eliminated. Such regimes have the tendency to inflate their administrative structures, rendering supervision more difficult and public action more inefficient: *Wintrobe* 2004; *Ginsburg* 2008.

[99] *Posner* 2001. Public law should create an accountability network for administrative officials: *Bignami* 2011.