Does agency design matter?

by Dr. Dóra Piroska
International Business School, Budapest

(Empirical Puzzle) Since the early 1990s, Central and Eastern European countries have been experimenting with legal reforms to establish a stable flow of credit to their economies. In this process, regulators faced the dilemma of increasing the attractiveness of their financial sectors to foreign investors by decreasing the legal burden on consumer credit while ensuring an adequate level of protection for consumers. By the late 2000s, an unwelcome development appeared in many CEEs, namely irresponsible credit contraction by a large segment of the population.

During the early years of building up the institutions of consumer protection, these countries have been largely responsive to the pressure of the same international institutions, politically influential states and private actors. However, the resulting regulatory regimes show marked differences in the institutional structure. In particular, the Independent Regulatory Agencies (IRAs) (Thatcher 2002), which are responsible for consumer protection in banking, show remarkable dissimilarities. In one model of institutional solutions, in Slovenia, the surveillance of consumer credit is located at the Consumer Protection Office, which is an IRA responsible for consumer protection in general. While in Hungary, in the other model, the responsibility is delegated to the Hungarian Financial Market Authority, which is only responsible for the financial market.

(Research questions) How does the institutional set up (different IRAs) influence the extent and nature of politicians' room for maneuvering in the governance of IRAs?

(Political and theoretical relevance) First, the primary motivation of this research project is a newly developed irresponsibility of many Central and East European consumers to contract credits with unbearable interest obligations. This irresponsibility is mainly present at the consumer product markets (well known examples include plasma TV sets, computer games, exotic holidays, etc.). But it has been also present at the mortgage market, where foreign currency denominated credits became the norm and consumers largely disregarded the associated currency risks. Politicians' rhetoric has become increasingly antagonistic with the banking sector; they tend to blame the banks for this situation. However, we should also investigate the extent to which politics is responsible for allowing the escalation of bad debts. This research will investigate to what extent they could influence the consumer protection agencies in enforcing public interest in the banking sector.

Second, although in the European Union the banking directives establish a framework of regulation (based on home state control, mutual recognition, and single banking license) that aims at enhancing the freedom of capital movement, regulation of consumer protection in credit agreements has so far only reached a preliminary status. The recently issued Modified proposal for a Directive on credit agreements for consumers amending Council Directive 93/13/EC provides a basis for common action. Provided that there is an ongoing negotiations among actors on the European Union level towards a new directive there is a need for an improved understanding of new member states practices in this field (Schimmelfennig and Sedelmeier 2005).

Finally, this research aims to contribute to the dynamically growing research field on the political economy of Independent Regulatory Agencies (Coen and Thatcher 2005; Levi-Faur 2005; Moran 1986; Thatcher 2002; Thatcher 2005). It examines the so far little studied Central and Eastern European region. Unlike many researches in this field, my research places an enhanced emphasis on the comparison of different agencies and it is interested in the interrelation of politicians' actions and the design of the agency. (Braithwaite and Drahos 2000; Scholte and Schnabel 2002).

(Research design) In order to explore the differences of political influence on consumer protection in finance in the new EU member states, I have opted for the most similar cases research design. Hungary and Slovenia were selected because of the following considerations: First, in the two countries the banking sectors credit providing activities are relatively similar. The ratio of domestic credit to households and enterprises is relatively similar as a per cent of GDP, both countries reached higher than 20 per cent in the examined period (IMF International Financial Statistics). Second, both countries were exposed to very similar influence of the European Union in amending consumer protection in general and in finance in particular.

Yet, the two states' policy makers opted for different institutionalization of consumer protection in finance and different organization of related state institutions emerged (i.e. state ownership of banks is high in Slovenia and low in Hungary, bank regulation is relatively closed in Slovenia and open in Hungary and bank supervision is relatively tight in Slovenia and loose in Hungary) (Piroska 2006). Finally, the density and activity of civil society of the two countries is very different (highly active in Slovenia and rather passive in Hungary). In sum, the juxtaposition of these two countries present a very promising contrast of institutionalization of consumer protection in finance in the Central and Eastern European region.

The examined time period is set between 2004, when the two countries became members of the European Union and 2008 when both countries experienced the impact of global financial crisis.

(Methodology and sources) The methodology adopted is sociological institutionalism. Concepts and analytical tools from the disciplines of political economy, international relations, and sociology of institutions will be used to sharpen the analysis. The main method used will be process-tracing. Numerous data sources will be mobilized, like primary sources (internal and official reports of the agencies, archival material like internal letters and notes, evaluations, etc.) and secondary literature (newspaper reports, scholarly analyses) which have partly been already accumulated. More research and reading needs to be done related to consumer protection in general and in finance in particular. These sources will be complemented with information collected through ca. 60 semi-directed interviews done between 2000 and 2004. Further interviews will help filling the gaps in order to answer more precisely the research questions presented above.

Sources:

Braithwaite, John, Peter Drahos. 2000. *Global Business Regulation*. Cambridge: Cambridge University Press.

Coen, David, Mark Thatcher. 2005. The New Governance of Markets and Non-Majoritarian Regulators. *Governance: An International Journal of Policy and Administration* 18 (3):329-346.

Levi-Faur, David. 2005a. The Global Diffusion of Regulatory Capitalism. *The Annals of the American Academy of Political and Social Science* 598:12-32.

Moran, Michael. 1986. Theories of Regulation and Changes in Regulation: The Case of Financial Markets. *Political Studies* 34.

Piroska, Dora. 2006. "Small Post Socialist States and Global Finance: A Comparative Study of the Internationalization of State Roles in Banking in Hungary and Slovenia" doctoral dissertation, CEU, Political Science Department, unpublished manuscript

Piroska, Dora. 2006. "Tulajdonosból szabályozó: A független szabályozó szervezetek európai elterjedése" (From Owner to Regulator: The spread of independent regulatory agencies in Europe, review article", *Külgazdaság,* L.évf. 4. szám, May 2006

Piroska, Dora. 2008. "The Implementation of the Basle Capital Accord in Hungary and Slovenia: The Role of Domestic Institutions" in Jutta Joachim, Bertjan Verbeek and Bob Reinalda (eds): International Organizations and Implementation, Routledge

Schimmelfennig, Frank, Ulrich Sedelmeier, ed. 2005. *The Europeanization of Central and Eastern Europe*. Ithaca, NY: Cornell University Press.

Thatcher, Mark. 2002. Regulation After Delegation: Independent Regulatory Agencies in Europe. *Journal of European Public Policy* 9 (6):954-972.

Thatcher, Mark. 2005. The Third Force? Independent Regulatory Agencies and the Elected Politicians in Europe. *Governance: An International Journal of Policy and Administration* 18 (3):347-373.