

Learning from corporate governance: First conceptualization of a liability for political decision-making

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Abstract

The institution of liability serves to mitigate the lack of care in almost all areas, whether private or business. However, we have not yet found such an institution in political decision-making. Surprisingly, the literature has not discussed a specific institution that subjects political actors who fail to exercise due diligence in their decision-making regarding personal liability. Hence, this paper aims to fill this gap and derive the necessity of internalizing the negative effects resulting from the imperfections of the market for political services in general and the democratic process, particularly by a liability rule. To design the new institution, we draw on the findings of corporate governance, combining economic thinking in incentives and legal knowledge expressed in the law of the corporation. In this respect, this paper is the first to make a concrete proposal for political liability accompanied by a political judgment rule. However, it is important to emphasize that the aim is not to punish a wrong decision but to provide strong incentives to prevent it ex ante. Political liability must be understood as a process-oriented institution that considers uncertainty and decision-making complexities. By proposing and analyzing this new institution, this work contributes to a broader discussion of incentive structures in the political process of modern democracies and shows how the political sphere can learn from the corporate world.

1 | INTRODUCTION

Politicians in a democracy are elected representatives of the population (i.e., citizens) for a certain period. In parliamentary democracies, political actors offer services that represent citizens through legislation or the government. The market in which they offer this service (e.g., Becker, 1958; Eichenberger, 2003) is characterized by numerous imperfections (e.g., Stadelmann & Frank, 2021, 2023). One crucial problem within the relationship between political actors and citizens is that most effects of political decisions only unfold in later legislative periods. The costs resulting from these decisions are not borne by political decision-makers but by the whole population, or at least parts of it. From the perspective of Public Choice (see, e.g., Downs, 1957; Mueller, 1976), it could be argued that there is considerable discretionary potential for political actors (e.g., Downs, 1957; Schumpeter, 1942 [2003]). This thesis can be easily justified from an economic perspective if we assume that a few characteristics are correct. Political actors are, like others, primarily interested in satisfying their own needs (e.g., Downs, 1957; Frey, 1994; Kirchgässner, 2013; Menger, 1871; Schumpeter, 1942 [2003]; Smith, 1776; von Mises, 1998 [1949]). Moreover, they have a high preference for the present (e.g., Hoppe, 1994) and are better informed than citizens (e.g., Daumann, 1999; Daumann & Follert, 2020; Downs, 1957). If we further accept that human action follows a more or less systematic weighing of the expected costs and benefits (e.g., Becker, 1976; McKenzie & Tullock, 1981), we can discuss how the costs of an—from a general welfare perspective—undesirable political decision can be borne by the decision-maker. This paper addresses the extent to which liability for policy decisions can help to internalize costs to the decision-maker and how this liability regime should be designed.

The argument is that a democratic system can be analyzed as a market in which parties or candidates offer their services. Citizens demand this offer during elections. The result is a principal-agent relationship between the political actor and citizens, which leads to a well-known moral hazard problem after the election. It is, therefore, understandable that after the election, when there is no commitment to promises, politicians base their decisions on their preferences (e.g., Ågren et al., 2007; Alesina, 1988; Levitt, 1996).

Given the features of the political processes in parliamentary democracies, it is surprising that politicians, unlike many other actors, are not personally liable for their decisions. To fill this gap in the literature, this paper proposes a concrete rule that subjects politicians to personal liability if they cannot present certain requirements for rational decision-making, especially documentation of their cost-benefit analysis, including the consideration of risks. However, we should be aware that most human, corporate, and political decisions are characterized by uncertainty (Knight, 1921; von Mises, 1998 [1949]) and incomplete information; therefore, universal liability would lead to disincentives for risk-neutral agents. To solve this problem, the law of the corporation must know the institution of business judgment rules. We borrow from this field and develop a conceptual framework for a politician's liability and the corresponding political judgment rule. To this end, we build our proposal on a theoretical framework that includes new institutional economics and an economic analysis of (corporate) law to show how the political sphere can learn from corporate governance. While parts of the literature study the influence of politics on modern corporations and their governance through a political economic analysis (e.g., Roe & Vatiero, 2018) and examine from which institutions of public governance companies can learn (e.g., Benz & Frey, 2005, 2007), we discuss the opposite.

The remainder of this paper is organized as follows. Section 2 presents the theoretical and institutional frameworks. We then compare the political liability rule with corporate law in Section 3 and design a concrete proposal that may be adopted by legislators. In Section 4, the proposal is discussed critically. Finally, the results are summarized in Section 5.

2 | THEORETICAL AND INSTITUTIONAL FRAMEWORKS

2.1 | Markets for political services, imperfections, and agencies

In a specialized society based on the division of labor, numerous markets exist in which individuals offer their skills and demand services from other individuals. Economic theory assumes that market participants are guided by the goal of satisfying their needs (e.g., Smith, 1776; von Hayek, 1973b). They value the exchange of goods and services based on their subjective preferences and are constrained by their specific possibility space (Menger, 1871; von Mises, 1998 [1949]). This approach allows the transfer of economic thinking to all human activities and related social situations (Becker, 1976; Frey, 1990). In this respect, the political process in a democracy can be interpreted as a market as well (e.g., Becker, 1958; Benson, 2011; Daumann & Follert, 2020; Downs, 1957; Eichenberger, 2003; Follert, 2018; Stadelmann & Frank, 2021, 2023; Stadelmann et al., 2020). In this market, certain individuals stand for election and offer political services that, if elected, they act as voter agents.¹ The election results in an (implicit) contract between the voter and the political actor, which is limited to the duration of the legislative period (e.g., Gersbach, 2012; Richter & Furubotn, 2010) where the citizen is the principal and the politician is the agent. For an elector's representation, the politician claims remuneration that represents the price of the service and is financed by taxes. In this sense, citizens are the original owners of state power and delegate power to their agents through voting (Richter & Furubotn, 2010). Although there are differences in other agency relationships—for example, the representatives enact laws through the legislative process that binds the principals and can be enforced against their will (Moe, 1990)—the basic problems are comparable (e.g., Lupia & McCubbins, 2000; Mitchell, 2000). The importance of organizational theory and the (economic) design of political institutions (Moe, 1990) is not new but has already been decisively elaborated by Moe (1990, 1991) 30 years ago. Markets for political services are characterized by the fact that information is incomplete and unequally distributed between politicians and citizens. If, as is common in Public Choice literature, we assume that political agents primarily seek to consume the amenities of their positions and continue this consumption unhindered under the condition of their re-election, then considerable discretionary potential arises (Downs, 1957; Frey, 1994; Schumpeter, 1942 [2003]). Consumption is limited by the upcoming election, and, understandably, government debt follows this time preference (e.g., Frey, 1977). Unfortunately, due to the contract length, which corresponds to one legislative term, the principal has little possibility of sanctioning his agent for misbehavior (see Daumann, 1999; Daumann & Follert, 2020; Follert, 2018, 2020).

However, compared with other markets, special features are rarely addressed in public discourse. The market structure is characterized by a large number of citizens confronted with comparatively few politicians. In such an oligopoly, it is not unlikely that price collusion will take place between the political sides, which we find concerning the price of the political actor's activity (the member or a parliament's salary), in that this price is imposed unilaterally (in the form of law) rather than through an interplay of supply and demand by the interaction of a majority of political actors (Follert, 2018, 2020).² Political actors set the price of their services in a manner similar to a monopoly. The subjective valuation—that is, the citizen's willingness to pay—is not considered, which leads to a loss in the signal function of the price. Thus, the level of parliamentary compensation is neither an indicator of the scarcity of service nor an indicator of the value of the activity.³

To overcome the problems posed by the typical features of the democratic process in an imperfect market, many institutional designs have been proposed to bind political actors and signal credibility to the electorate

¹To reduce the complexity and focus on the theoretical idea, we assume here a supply side consisting of political actors and a demand side consisting of voters. In practice, a differentiation must be made insofar as political actors are grouped into different parties and countries have different electoral systems.

²An alternative regulation is proposed, for example, by Gebauer (2021, p. 40) and Follert (2020, pp. 177 f.), who advocate linking the salary to a reference price derived from the average salary outside politics before the term of office and in this respect also reflecting the idea of individual opportunity costs.

³Of course, it is not conceivable in practical terms that the remuneration of the political actor is negotiated individually, yet it would be conceivable that certain bodies (Follert, 2018, p. 244), representing the political actor and voters, respectively, negotiate a price at the beginning of each legislative term based on a system similar to collective bargaining parties.

(e.g., Moe, 1990; North, 1993; North & Weingast, 1989).⁴ For example, political actors outsource certain activities (such as monetary policy) to formally independent institutions in the sense that they delegate them. However, we increasingly observe a politicization of those institutions that could lead to de-delegation (e.g., Bodea & Garriga, 2023; Thatcher et al., 2023), so credibility may in turn suffer.

This paper addresses a different institutional level and examines political actors' decisions from a micro perspective. The goal is to channel decisions through appropriate institutions from an *ex ante* perspective.

2.2 | Incentives matter: Liability from a law and economics perspective

In particular, the problems described in the context of agencies (e.g., Arrow, 1985; Ross, 1973) are well known in various other fields, such as the economic analysis of corporations (e.g., Fama & Jensen, 1983; Jensen & Meckling, 1976). If the decision and disposal rights lie with the same person, the decision process can be neglected with regard to goal effectiveness (Fama & Jensen, 1983). However, if the decision-making authority lies with the agents, it makes sense to channel the decision-making process such that agents do not exploit their informational advantage to the detriment of principals. The danger of moral hazard exists, particularly if there is asymmetric information and risk-bearing as well (Arrow, 1971; Holmström, 1979; Pauly, 1968). New institutional economics (e.g., Richter & Furubotn, 2010) and research in the field of corporate governance recognize the possibility of reducing the discretionary potential of opportunistic agents through incentives.⁵ To achieve this, it is necessary to design appropriate institutions that can influence behavior *ex ante*. In this respect, managerial liability is a well-known corporate issue. From a strictly legal perspective, the key motivation for establishing liability is the compensation of the injured party, that is, corrective (e.g., Cooter & Ulen, 2012; Posner, 1981). In contrast to this *ex post* perspective, economics focuses on influencing behavior, which is also addressed as the primary goal of the case considered here. Overall, we accept the claim that people try to improve their situation through actions compared to their current state (Lindenberg, 1985; McKenzie & Tullock, 1981; Opp, 1985, 1999; Von Mises, 1944; von Mises, 1998 [1949]). The fact that improvement from a retrospective perspective is not always successful is another matter and is due, for example, to the available information at the time of the decision, its processing, and the uncertainty of each decision (Emrich & Follert, 2019; Lindenberg, 1985; Opp, 1985, 1999; Simon, 1955). Therefore, we generally assume that people are guided in their actions by at least an intuitive weighing of the expected benefits and respective costs based on their individual preferences (e.g., Kirchgässner, 2013; McKenzie & Tullock, 1981). In particular, the consequences of an action can often be determined with a time lag and are therefore uncertain. Thus, the price of an action is the product of probability and cost, which can be, for example, a penalty, as Becker (1968) demonstrates by analyzing the rationality of crimes. Consequently, the more expensive an action becomes, the more probable the occurrence of negative consequences.

The effects of entrepreneurial and managerial decisions are rarely foreseeable at the time of decision. Eucken (2004 [1952], p. 280, translated by the author) is considered an advocate of the principle of liability in the market economy: "Who has the benefit must also bear the damage." From an economic perspective, the institution of liability can set incentives to follow a structured process based on a well-founded discussion of possible scenarios. To explain this, we must consider that the consequences of an agent's decision do not affect the decision-maker but

⁴The results presented by Wang and Yu (2022) show that the negative effects of political embeddedness for Chinese firms can be reduced if the uncertainty for government officials—for example, through replacement—increases, thus reducing discretionary potentials.

⁵It should be noted that the principal-agent approach is not considered adequate for the analysis of public corporations by parts of the literature. In particular, it is pointed out that agency theory assumes an agent who does not want to pursue the principal's goals, but it may also be the case that his ability is not sufficient to achieve the goals (Blair & Stout, 1999). Moreover, the risk of opportunistic behavior does not affect only the agent but should be considered symmetrically for the principal as well (e.g., Sobol, 2016; Wagner, 2019). Furthermore, it can be argued that relationships within the corporation could have the character of a team production rather than that of a pure delegation (Blair & Stout, 1999). However, this critique is of secondary importance for the following discussion, because the design of the institution proposed here is process oriented and does not focus on whether the goals of the principal are fully implemented (see Section 3.2).

directly affect the company and indirectly affect the owners (e.g., Fama & Jensen, 1983). The goal behind the institution of liability is, therefore, to internalize the negative effects, that is, the costs to the decision-maker (Coase, 1960). The economic consideration is that the probability of an incorrect decision leading to costs for the principal can be influenced by the standard of care with which the agent prepares the decision and analyzes the relevant decision parameters. For this purpose, it is assumed that this probability is a decreasing function of the care level (e.g., Cooter & Ulen, 2012). The central aim of a liability rule is that the decision-maker chooses an optimal level of care in his or her decision process, where the total costs reach a minimum (Coase, 1960; Cooter & Ulen, 2012). On the other hand, if there is no liability, the agent only considers the costs incurred by him or her and chooses a standard of care that is too low, because the preparation of a careful decision is, in turn, associated with costs, which leads to rising total costs.

However, the universal liability that is not linked to a violation of a certain standard of care creates the risk that economically sensible projects cannot be realized by a decision-maker who is not willing to take risks (e.g., Pies & Sass, 2010). To achieve internalization of negative external effects and thus a behavioral control effect on the one hand, but on the other hand not to set false incentives and to take sufficient account of the imperfection of the decision-making situation, it is necessary to have a liability exemption corresponding to the liability. If there is no possibility of exemption from liability, a risk-averse decision-maker tends to realize only projects with low risk. Of course, liability also affects the self-selection of political actors. In principle, this should have positive effects, insofar as individuals who seek office out of opportunistic motives would have less incentive to pursue careers as politicians. However, care must be taken when designing to ensure that risk-averse individuals are not deterred.

3 | DECISION-MAKING AND LIABILITY: A SYNTHESIS OF THE CORPORATE AND THE POLITICAL SPHERE

3.1 | Why is there no liability for political decision-making so far?

When we assume that if a political actor, such as people in general, responds more or less systematically to incentives, an increase in (expected) decision costs can trigger a behavioral change. Concerning a formal and, therefore, explicit institution that leads to higher costs for the political actor, this study proposes the introduction of politician liability. The internalization of the consequences of a decision in the hands of a political actor should have an *ex ante* behavioral control effect. As shown, the unity of decision and liability is a cornerstone of the market economy, and from an economic perspective, it is difficult to see why politicians should not bear personal responsibility for their decisions. Gersbach (2017, p. 4) stated:

What we need is a device that can complement elections and can be integrated into a democracy. One of our major ideas is that officeholders should be rewarded for promises kept and punished for broken promises.

However, in the parliamentary system, this sanctioning is only given to a limited extent, which opens up discretionary potential. The steering effect can be achieved if politicians are liable to make decisions based on private assets.

We have found that the agency between citizens and political actors in a parliamentary democracy offers discretionary potential for the political actor as the administrator of other people's property (e.g., Hoppe, 1994), which they can exploit in their interests at the expense of the voter. From an economic point of view, it is obvious that it is a central problem that poor political decisions sometimes do not entail any personal consequences for the political actor, so, according to economic understanding, a so-called "low-cost decision type II" exists, the characteristic of which is that the decision-maker himself does not bear any personal consequences, but the consequences of the

decision unfold corresponding effects for other individuals (Kirchgässner, 1992). This is astonishing because the law of the corporation, which has a comparable agency relationship, at least in conceptual terms, has established liability for the decisions of directors and officers unless the decision-makers can prove that they have complied with certain features of a structured decision-making process. The first question is why such institutions have not found their way into the political system. On the one hand, it can be argued that parliamentary democracy cannot be compared to a corporation in terms of its degree of complexity. However, this seems unsatisfactory because a corresponding liability for the political actor does not necessarily have to be structurally identical to the liability for the management of a corporation. Another *prima facie* simple but politico-economically understandable answer would be as follows: Politicians make laws, and if they introduced such an institution, they would make themselves worse off. However, it should be noted that establishing liability for political missteps that demonstrably do not meet the requirements of a sound decision-making process would send a self-binding effect and thus a signal of credibility, which could generate some trust among voters (Follert, 2018). Particularly in times of economic and political crises, as well as a rise in populism in many Western countries (e.g., Caiani & Graziano, 2016, 2019; Caramani & Manucci, 2019), sensibly designed institutions may be able to restore confidence in political action. Moreover, it can be conjectured that the decision quality improves when certain process rules are followed.

Another explanation for the absence of political actors' liability in contrast to corporate managers could be that the target function of a manager can be more clearly defined (e.g., by financial parameters, see Follert et al., 2023) than the objectives of a politician. This is correct and is the main reason why corporate liability cannot simply be transferred to the political process and why a deeper discussion of the requirements is necessary.

Based on an economic analysis of the purpose of a (politician) liability, the following section elaborates on the requirements of such an institution. Based on an analogy to corporate law, we aim to design liability for political actors.

3.2 | Designing liability for political decision-making

3.2.1 | Standard of care

Following the economic analysis of general tort law (Calabresi, 1970; Cooter & Ulen, 2012), we assume that a "strict liability" is less appropriate with a look at the complexity of political decision-making. To design an effective institution, we need a negligence rule (see Posner, 1972) that tells us when a political actor's conduct in a decision-making process constitutes a breach of duty. To this end, it is necessary to clarify the duties that a political actor must fulfill within the framework of the decision-making process.

Considering the corporate sphere in the United States, directors and officers must be differentiated. Owing to its extensive freedom—for example, in the appointment and dismissal of officers and the responsibility that goes with it—its position as a director entails an extensive *duty of care* and an equally extensive *duty of loyalty*. The duty of care is generally based on tort law and requires a director to exercise the care that a *reasonable person* would exercise under similar circumstances (Clark, 1986; Klein et al., 2010). The directors' duty of loyalty is not to be understood as an abstract construct but is rather discussed in academic research and practice in the context of concrete case scenarios (Klein et al., 2010; Sparks & Hamermesh, 1992). The basis of officers' duties is a contract between the officers and the corporation that allows them to represent the corporation. To keep things simple, we do not examine differences in duties depending on the respective hierarchical level but state that the duties of executive officers are comparable to those of directors (Pinto & Branson, 2018). Therefore, in the following, we will speak of *managers*, by which we mean the highest decision-making level. This also makes it possible to appeal to jurisdictions with other corporate governance structures (e.g., Germany). These individuals have in common that they manage third-party property in a fiduciary capacity and make entrepreneurial decisions as agents for the owners. Thus, in the case of a manager or, as in the context discussed here, a politician, it is

necessary to ask whether agents have breached their duty to clarify whether they are liable for a decision. It seems to make sense to follow tort law and focus on the duty of care, especially because the assessment of the duty of loyalty must be analyzed in individual cases, as already mentioned. It is also undisputed that politicians have legal duties. They must abide by the law in their decisions.

A politician's liability cannot be a liability for success, as it would lead to unintended incentive effects, especially for risk-averse types. Rather, it was a culpable breach of the duty of care. Corporate law applies a higher standard to management than ordinary businesspeople (Spindler, 2019). These results, in particular, depend on the agent's position. In a corporation, liability exists only if a decision was *not made* with relevant due regard for diligence. It is also essential for liability for political decisions, similar to management decisions, that liability does not start in the case of mere misjudgments or errors (Koch, 2023), but only if the heightened standard of care of a politician elected to office based on his competences as a representative of the citizen is disregarded. In this context, it also seems useful to distinguish between areas of specialization. Spindler (2019) points out that a different standard must be applied, for example, to a bank manager rather than to a manager in another industry. If we transfer this to the political process, there may be distinctions among specialist politicians in their evaluation of a decision. A different standard would be applied to a finance minister on tax issues than to the same finance minister as a cabinet member on health issues, which applies the opposite to a health minister on public health decisions.

Concerning the managerial standard of care, Section 93 I Aktiengesetz (*German Stock Corporation Act*) (AktG) formulates the following:

In managing the affairs of the company, the members of the management board are to exercise the due care of a prudent manager faithfully complying with the relevant duties.

In accordance with the above and by analogy with the provisions of stock corporation law, we formulate *de lege ferenda* as follows:

In their political decisions as representatives of citizens, politicians are to exercise the due care of a prudent representative faithfully complying with the relevant duties. In particular, they must exercise due care commensurate with their importance as temporary fiduciaries.

3.2.2 | Standard of judicial review

Within the law of a corporation, a question arises regarding the verifiability of compliance with the duty of care. Unlimited liability not linked to specific verifiable facts generally leads to misguided incentives. In addition to managers, political actors often face unexpected events (e.g., Rosenthal & Kouzmin, 1997). Therefore, political decision-making takes place under uncertainty and limited information, so in a decision-theoretical sense, we speak of ill-structured decision problems (Simon & Newell, 1958). From a decision-oriented perspective, uncertainty has two dimensions (see, e.g., Gleißner, 2021): On the one hand, the environmental influences, that is, the decision field, can change. A good example is the German government's decision to phase out nuclear power prematurely after the Fukushima disaster in 2011 (Follert et al., 2021). At the latest, the situation changed completely owing to the Russian war against Ukraine and the subsequent gas shortage (e.g., Gleißner & Follert, 2022). On the other hand, measures by which decisions are made are accompanied by uncertainty. Unilateral liability could encourage an overly cautious assessment; therefore, opportunities—for example, for fundamental reforms—are not seized. Therefore, the aim of liability is neither to restrict political actors' decision-making freedom nor to place political action under general suspicion. In contrast, liability can ensure that decisions are made on a more informed basis, especially concerning cost, benefits, and risk. In particular, decisions must be documented concerning the process and assumptions so that an ex post review under the conditions valid at the time of the decision to avoid hindsight bias

(Fischhoff, 1975) can occur (e.g., Follert et al., 2021; Gurrea-Martinez, 2019). To the extent that ex post reviews of the information underlying a decision and its evaluation are possible, political actors must exempt themselves from personal liability by proving that they apply an adequate standard of care in the context of their decision. Consequently, the institution of politician liability should be accompanied by a rule that grants political actors immunity from liability provided certain characteristics are met.

Concerning corporate law, we can observe that there already exists an explicit *business judgment rule*, which is a cornerstone of US corporate law and has been adopted in several jurisdictions (e.g., Johnson, 2013). If it is questionable whether a breach of the duty of care has occurred, the business judgment rule is a benchmark for courts to review managerial decisions (Clark, 1986; Klein et al., 2010). In its landmark decision in 1829, the Supreme Court of Louisiana emphasized that a decision-maker could not be held liable for damages resulting from an error that would have occurred even if he had acted diligently (Percy vs. Millaudon, 8. Mart. 68; Louisiana Supreme Court 1829). If its requirements are fulfilled, the court refrains from measuring the decision against the criteria of due care and from reviewing the content of the managerial decision. However, if the decision-maker leaves this safe space, the protection ceases to apply, and the court has the possibility of a full review of the content of the decision.

In this regard, a strict standard of care seems to be generally incompatible with managerial decision-making, as the peculiarities of entrepreneurial activity should be considered (Gurrea-Martinez, 2019). Entrepreneurial activity is inconceivable without a willingness to innovate and take risks, which is why principals also have an interest in encouraging agents to see not only the risks but also, in appropriate consideration, the corresponding opportunities when entering into business transactions (e.g., Gurrea-Martinez, 2019; Olbrich & Rapp, 2013; Sharfman, 2017). In this respect, courts recognize that decisions in a business context, owing to omnipresent uncertainty, can prove erroneous from an ex post view. Simultaneously, the business judgment rule prevents judges from entering the terra incognita of management decisions (Clark, 1986). In 1984, the Delaware Supreme Court (Aronson v. Lewis, 473 A.2d 805, 812; Del. 1984) emphasized the following:

It is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Kaplan v. Centex Corp., Del.Ch., 284 A.2d 119, 124 (1971); Robinson v. Pittsburgh Oil Refinery Corp., Del.Ch., 126 A. 46 (1924). Absent an abuse of discretion, that judgment will be respected by the courts. The burden is on the party challenging the decision to establish facts rebutting the presumption. See Puma v. Marriott, Del.Ch., 283 A.2d 693, 695 (1971).

The business judgment rule has been codified in numerous countries; for example, in section 93 I AktG:

No dereliction of duties will be given in those instances in which the member of the management board, in taking an entrepreneurial decision, was within their rights to reasonably assume that they were acting on the basis of adequate information and in the best interests of the company.

A structural difference is whether the business judgment rule is formulated as a “presumption” or as a “safe harbor” (e.g., Gurrea-Martinez, 2019). However, based on long-standing practices in the United States, formulation of other laws, and economic evaluation of the decision situation, several features can be identified (e.g., Sharfman, 2017).

- An entrepreneurial decision, that is, a decision under a high degree of uncertainty;
- must be based on valid information;
- a certain degree of reasonableness must be established; and
- the decision-maker must consider the welfare of the corporation respective shareholders.

An analogy of the business judgment rule to political decision-makers was already proposed by German lawyer Gebauer (2021, translated by the author), who proposed a formulation for politician liability in the event of a breach of the “due care and diligence of a prudent and conscientious” political actor:

No dereliction of duties will be given in instances in which the political actor, in making a political decision, was within their rights to reasonably assume that they were acting on the basis of adequate information and in the best interests of the population.

The decision must obviously be a *political decision* in the sense of a decision under imperfect conditions. Therefore, they must not be well structured. By a well-structured (decision) problem, Simon and Newell (1958, p. 5) mean “those that can be formulated explicitly and quantitatively, and that can then be solved by known and feasible computational techniques.” Rapp and Olbrich (2020, p. 5) emphasize that “entrepreneurs make specific decisions, predominantly acting in contexts where well-structured problems are rare, if present at all.” If this already applies to a corporation, where a distinctive set of specific data exists in which most criteria are quantified, this must apply, especially in politics. Consequently, it is clear that there is no optimal solution to the decision problem *ex ante* because of structural defects (e.g., Adam, 1983; Adam & Witte, 1979; Rapp & Olbrich, 2020, 2021; Simon, 1973; Simon & Newell, 1958). In the context of political decision-making, goal defects will often occur because, for example, there are conflicting goals. However, the valuation of certain goal variables is problematic because parameters such as peace, freedom, and health are often difficult to transform into quantitative variables. Additionally, in complex decision-making situations, it is seldom possible to establish perfect cause-and-effect relationships.

The second characteristic *in the best interest of the population* should be rejected from both an economic perspective and practical considerations. From the perspective of methodological individualism (Boettke & Coyne, 2005; Schumpeter, 1908 [2010]), notions of collectivity must be viewed with caution. Citizens' preferences are highly heterogeneous. Arrow (1951) showed that individual preferences cannot generally be aggregated into a social welfare function under the conditions we take to be given for a democracy. Stock corporations with numerous owners are familiar with this problem. Although it is sometimes proposed to construct an individual corporate interest, this also runs counter to methodological individualism, so the management board of a corporation must assume certain characteristics for a stereotypical shareholder (e.g., Olbrich, 2006), which will guide its decisions. For legal and political reasons, it is already difficult to imagine a meaningful typification in the context of a politician's liability, which makes operationalization difficult. From an economic perspective, it would at best be comprehensible regarding the efficiency criterion that specific addressees are typified for certain decisions and that it is demonstrated that their benefits from a decision more than compensate for the economic disadvantages of other groups so that the overall welfare effect is positive. It could also be argued that, instead of focusing on a social welfare function that presupposes the transitivity of political decisions, it is based on a decision function that merely requires acyclicity, as suggested by Frey (1977). However, this is not a verifiable criterion. Therefore, we did not examine this in further detail for the economic and practical reasons stated above.

Because of the problems discussed, a political judgment rule *de lege ferenda* could be formulated as follows:

No dereliction of duties will be given in those instances in which the political actor, in taking a political decision, was within their rights to reasonably assume that they were acting on the basis of adequate information which is presented by a transparent and structured decision process.

The requirements for a transparent and structured decision-making process have been added. The characteristics of *adequate information* and the requirements for a *transparent and structured decision-making process* require detailed analysis and concretization (see Section 3.3).

The politician has the burden of proof for this, which is derived from an analogy of German stock corporation law (section 93 II AktG). If the prerequisites for the facts are fulfilled, liability follows insofar as the politician is personally liable for the damage caused by the decision.

3.3 | Concretization: Liability as a process-oriented institution

Legal rules should not be too specific to allow adaptation to dynamic social development (e.g., von Hayek, 1973a, 1991). Therefore, in the following, the requirements for *adequate information* and a *transparent and structured decision-making process* will be concretized, similar to what is usual in legal commentaries as supplements to laws (e.g., Kästle-Lamparter, 2016). In line with Gleißner (2021, p. 16) who emphasizes that the managerial liability is not a “liability for the result of a decision, [...] [but] for the preparation and presentation of decisions,” we advocate the new liability for political decisions as a process-oriented institution. Therefore, it is primarily a matter of structuring the decision-making process according to clearly defined steps to verify whether the duty of care has been violated.

First, political decisions must be based on *adequate information*. Information can be interpreted as “purpose-related knowledge” (Wittmann, 1959, p. 14), which clarifies that context-specific knowledge underpins a specific decision. At the same time, it is obvious that only this information is relevant and can be obtained at a reasonable cost at the time of the decision (Follert et al., 2021). Because information is incomplete, the optimal degree of information acquisition, which also applies to the decision of a politician, is the intersection between the marginal cost of information acquisition and the marginal utility of the information (Laux et al., 2018). If we abstract from the electoral considerations of political actors, the challenges in the preparation of political and entrepreneurial decisions under uncertainty are largely identical (e.g., Follert et al., 2021). Every decision comes with expected costs and benefits.⁶ Therefore, adequate information must include weighing the costs and benefits of a decision based on risk aspects. Follert et al. (2021) outline such a risk-adequate decision assessment based on the early phase-out of nuclear energy by the German government in 2011. To this end, the goal of the decision and subsequent measures must first be clarified (see also Gleißner, 2021; Graumann et al., 2009). In a decision-theoretical sense, the decision field (possibility space), that is, alternative actions, must be delimited. To prepare for the decision, it is necessary to determine what benefits a certain action brings in comparison with its alternatives and what costs have to be raised for this (Gleißner, 2021). For this purpose, it is necessary to forecast the costs and benefits of relevant alternatives, such as the economy, social issues, and geopolitics. In the case of costs, it must be emphasized that not only the direct costs but also the indirect costs of a measure must be considered. As with strategic management decisions, a course of action may involve a specific increase in certain risks, to reduce other higher risks (Gleißner, 2021). Research in the field of (corporate) risk management, including decision and valuation theory, has developed a broad set of tools for dealing with uncertainty in the context of business decisions, which should also be part of conscientious political decision-making, such as quantitative risk analysis, with the help of Monte Carlo simulation (e.g., Hertz, 1964). However, the quantitative risk assessment does not exclude the extension of objectives to include normative aspects and does not adequately restrict the freedom of political actors (e.g., Daumann et al., 2022).

In the above example, Follert et al. (2021) assume that a decision-maker has two options: “keep nuclear power plants running” versus “phase out 2022.” The risk that determines the uncertain costs and benefits can be worked out on three different levels:

1. risk of a maximum conceivable accident and potential damage (i.e., probability);

⁶Under uncertainty, no objective probabilities for future costs and benefits are known by the decision-maker, which requires to deal with deviations from the expected values. For the sake of simplicity and in order not to lose focus, we will therefore refer to “risks” in the following, knowing full well that this removes the separation of uncertainty and risk as made by Knight (1921).

2. side risks were triggered by an early phase-out because a reduction in the risk of 1. could lead to an increase in other risks such as critical dependencies; and
3. non-intended effects result from measures such as investment in nuclear power in neighboring countries.

In managerial decision practice, a qualitative analysis of risks and an overall assessment are first performed to determine the overall scope of the risk (Follert et al., 2021; Gleißner, 2019). This requires translating potential harm into quantitative figures, which can be difficult in part (Follert et al., 2021), but is already a common practice in public health.

Moreover, the process of risk-adequate assessment of the costs and benefits of a measure must be documented. The preparation of a decision template known from the corporate context can be seen as a benchmark for the second requirement: a *transparent and structured decision process*. Management practice has revealed numerous pitfalls (Gleißner, 2021) that political decision-makers could learn from when documenting their decisions, and we discuss two problem areas in particular:

- The analysis of costs and benefits is not neutral and primarily serves as an argumentative value.
- The presentation of the assessment of costs and benefits is inadequate.

There is, of course, the danger of political actors deliberately presenting information in a positive light, downplaying risks, and having their assessments confirmed by appropriate consultants or experts. We know from M&A transaction practice that managers aim to protect themselves through so-called “fairness opinions” as far as the purchase price determination is concerned. These “fairness opinions” also primarily serve to exonerate the management board and function as argumentation values (e.g., Follert & Gleißner, 2022; Zimmermann, 2016). An effective means of countering this behavior could be political opposition to selecting experts to accompany the decision-making process on the government side.

To address the second problem, the overall objective of the decision-making process is to produce a decision paper. This must elaborate on the initial situation, goals, alternatives, expected costs, and benefits (e.g., Gleißner, Stein, & Wiedemann, 2021). In particular, the key assumptions underlying the assessment (e.g., regarding the probabilities of future states) must be made transparent.

On the one hand, such a procedure allows the documentation of all available and relevant information at the time of the decision, as well as its evaluation, and can serve as relief for the political actor (e.g., Daumann et al., 2022; Gleißner, Follert, et al., 2021). On the other hand, the critical parameters are once again brought to the attention of the political decision-maker, which makes serious preparation for the decision more likely and can promote a higher standard of care. Finally, an overall assessment of the various options for action must be conducted considering the predicted benefits and expected risks (risk-adequate assessment).

It is just as relevant for the political context as for the managerial decision-making process that cost-benefit and risk analyses, which are usually prepared by consultants, do not need to contain a recommendation (Gleißner, 2021) and, given the free decision of a political actor, probably should not.

Finally, the question arises whether the regulation should be designed as a “presumption” or as a “safe harbor” (see Gurrea-Martinez, 2019). While US law assumes the former, a safe harbor, as in German stock corporation law, requires political actors to prove that it has fulfilled these characteristics. On the one hand, a safe harbor rule leads to an increased documentation cost or probably “over information,” which could result in inefficiencies (Gurrea-Martinez, 2019). On the other hand, it forces the political actor and the advisors to prepare the decision to look more closely at possible consequences. There is certainly a tradeoff. Overall, the aim of the proposed criteria for the political decision-making process is to clarify the objectives of a measure and identify alternative courses of action and associated risks (e.g., Daumann et al., 2022). The crucial factor is that these considerations are well documented, and their influence on possible target variables is sufficiently analyzed. Thus, regulation can have a behavioral steering

effect. Therefore, it is not at all a matter of punishing a wrong decision through personal liability but of providing incentives to prevent this wrong decision from occurring in the first place.

4 | CRITICAL DISCUSSION AND LIMITATIONS

The actual effectiveness of the new institution proposed here in the form of liability for political decisions can only be tested empirically. From a theoretical perspective and with a view to the design presented in this paper, some indicators suggest that the incentives are designed such that such an arrangement leads to more rational decision preparation and decision-making because they follow a structured and transparent process. Whether this benefit exceeds the potential costs of introduction can be assumed but cannot be conclusively assessed a priori. In the following section, we discuss some possible disadvantages that politicians' liabilities for their decisions could entail.

One argument against the liability rule proposed in this article is the bureaucratic costs that might be created. Decisions that follow an intersubjectively verifiable process require appropriate documentation, which leads to documentation and time costs, which is also known from management practice and is often an objection to new institutions (Gurrea-Martinez, 2019). However, it must be noted that a corresponding structuring of the decision-making process must go hand in hand with a certain standardization so that both experiential learning and cost benefits occur with a large number of decisions. It could be efficient to establish management and reporting systems in the political decision-making process, analogous to those in the corporate sphere (Gleißner, 2021), which would enable the standardization of the preparation and review of decision templates. In this regard, it must be clarified which departments and agencies—e.g., in a ministry—must be involved. To keep decision costs as low as possible, there should be process steps for each decision type, the standardization of which increases or decreases depending on the complexity of the decision.

Another disadvantage resulting from the introduction of personal, and thus, generally, monetary, liability is the potential threat to economic existence. Risk-averse actors are likely to lead them either not to enter the market for political services at all or to make only those decisions in which the potential deviations from expected values are comparatively small. In many cases, this could lead to situations in which important reforms are not being undertaken because the effects may be of high uncertainty. It is worth reiterating that our initial argument builds on an understanding of political services as markets. However, if we understand politician's liability as the logical consequence of a market-based view of the political process, then it is logical that political actors should be allowed to insure themselves against this personal liability. In this respect, we can draw an analogy with corporations. Liability insurance is not only established in the private context but is also an instrument with which, for example, members of certain professions can insure themselves against recourse to their private assets. There is also a market for directors of stock corporations in which the so-called directors and officers (D&O) insurance policies are offered (Holderness, 1990; O'Sullivan, 1997). However, insurance may also lead to moral hazard and behavior with a lower standard of care, which could potentially counteract the benefits of the institution of liability (Arrow, 1963; Pauly, 1968; Shavell, 1979). Therefore, from an economic perspective, such insurance must not provide full coverage. For example, it is conceivable that a corresponding insurance policy would provide for the participation of a political actor as an insured person in each claim as a function of his or her income (e.g., Gebauer, 2021).

Moreover, the transformation of the relevant parameters into quantitative figures is problematic and potentially costly. Prima facie, there may be resistance to transforming health, freedom, and other values into monetary figures. However, it should be noted that policy measures have already been evaluated, and empirical research approaches the assessment of such measures using various proxies (e.g., Gandjour, 2021, 2022).

Another potential disadvantage is the danger that such an institution will be used by the opposition to improve their chances before an election and discredit the current government. This raises the question of who is entitled to take legal action against politicians who may not exercise the required decision-making. One suggestion is to establish a non-partisan commission to which citizens can turn. If a quorum is present, the Commission must take action

and file a lawsuit to allow the court to investigate the case. To prevent opportunistic behavior, the chair could be a comparatively neutral person, such as the president of parliament.

A more fundamental critique of our proposal could be the focus on an “economic” decision calculus in general. However, this accusation seems unjustified because the increase in costs for the political actor can also occur in an immaterial manner. There are several possibilities for implicitly increasing costs. A more socioeconomic approach would be to focus on norms in the context of decision-making (e.g., Yin et al., 2021, 2023). Norms affect an individual as an “internal sanctioning system which provides punishment when he carries out an action proscribed by the norm or fails to carry out an action prescribed by the norm” (Coleman, 1990, p. 293). In this specific context, a relevant norm could be (and presumably is) that the political actor must keep promises made before the election, at least under certain conditions, or that one should refrain from making political decisions where the (subjective) probability of the occurrence of strong negative consequences is relatively high (e.g., probability > .5). In the case of conditional norms, the cost of the negative consequences for policymakers increases. Thus, moral behavior can be interpreted as an aspect of rational action (Opp, 2013). Such norms also play a role in corporations. For example, in the field of business economics, especially in the German-speaking world, we know the image of an honorable merchant (*ehrbarer Kaufmann*, e.g., Albach, 2003, 2005), for whom it is important to build up a reputation and to behave in a contractually faithful manner toward customers, employees, and suppliers, that is, all those persons to whom the honorable merchant makes promises (e.g., Follert et al., 2023). These norms can also have an important binding effect in the political arena. This is likely to be more relevant if there are corresponding norms on the demand side, that is, among voters. One example would be the norm that non-compliance with election promises is only accepted under certain conditions, for example, if coalition negotiations take place after an election in which compromises are made that violate election promises. This can diminish the reputation of political actors and affect the popularity of parties, leading to costs. In this respect, the corresponding socioeconomic approaches are understood as complementary to rather than countering the liability institution proposed here.

Regarding the concrete operationalization of such a new institution, the question arises as to the specific addressee. In this paper, we have only referred to a “political actor” to focus on the assumed economic effects. On one hand, it is conceivable that political liability refers to an individual member of parliament (Gebauer, 2021). However, the current political system has two problems. First, members of parliament in most democracies represent not only their constituency, if elected by direct mandate, but also the entire population (on this discussion, see Follert, 2018). Second, practical usances, such as the so-called “factional coercion,” make operationalization difficult. At the same time, however, politician liability could have the effect of making each member of parliament consider the opportunities and risks of his or her decisions. However, it is advisable to focus on executive decisions as a first step. To understand this, the German government's decision to distribute FFP-2 masks via local pharmacies during the COVID-19 pandemic served as a prime example (see Gleißner & Follert, 2021). In 2021, 35 million German citizens would be given 15 masks each. This procedure resulted in costs of EUR 2.5 billion, with the market price at that time being EUR 0.5 billion (Gleißner & Follert, 2021). The main amount comprised the transaction costs resulting from distribution by pharmacies. Other alternatives, such as the direct mail of FFP-2 masks by post, were not considered (Gleißner & Follert, 2021). With this inefficient decision despite an obviously better alternative, the time aspect in terms of quick decision-making cannot be an excuse either. If there had been an institution such as the one proposed in this paper, the German Ministry of Health would have had to explain how this decision was reached, weighing the costs and benefits against the best alternative course of action.

Fundamentally, the argument arises as to whether liability for political decision-making might undermine the central democratic principle of the separation of powers, that is, whether judges evaluate political decisions. Therefore, it is important to emphasize once again that it is primarily a matter of assessing the standard of care, which can be documented based on adequate information and a structured and transparent process. Thus, judges do not assume the role of politicians. Rather, the question arises as to why, of all things, political actors' due care should escape judicial review.

5 | CONCLUSIONS

Based on an economic foundation, this study develops a new institution for parliamentary democracies. The design of liability for a political actor is derived from an incentive-oriented view and flanked by a political judgment rule borrowed from corporate law that guarantees freedom from liability, provided that the defined requirements for decision-making are met. In particular, a decision that meets the standard of care requires a risk-adequate weighing of costs and benefits, depending on the best alternative action in the decision field. Assumptions regarding forecasts must be made transparent and documented in a decision template to verify the decision-making process intersubjectively ex post. Therefore, the institution of liability for political decisions can be understood as process-oriented. However, the proposal presented here cannot and does not intend to replace the discussion of constitutional law or democratic theory. Rather, the aim has been to derive the need for liability for political decision-making on the one hand and to design a comparatively concrete institution on the other.

We focus on the incentive effect, derivation of the necessary criteria of liability for political actors, and operationalization of certain characteristics under which liability does not occur. What we have omitted is the question of legal consequences and, in particular, the assessment of potential damages. In other words, what value should be attached to wrongful decisions in concrete terms? This represents a potential avenue for future research. What has also not been considered in this paper is which instances of courts have investigated these cases. Legal and political science expertise is required for future research.

For further development, however, other scientific disciplines must participate in the possible operationalization of this institution. Ultimately, however, it is up to the legislators to decide whether such an institution will find its way. It can be argued that those affected by such institutions are unlikely to support such legislative proposals. However, a counter-argument would be that political actors themselves could also benefit from a corresponding increase in the cost of their decisions—e.g., by building trust among citizens. It is important to clarify again that the goal of the institution is not liability per se but to prevent liability by fulfilling the essential features of decision preparation.

ACKNOWLEDGMENTS

I am very grateful to the two anonymous reviewers and *Kyklos* editor David Stadelmann for their constructive and valuable suggestions, which helped to improve the paper. Furthermore, I would like to thank Karl-Dieter Opp and Andre Briviba for their helpful comments on previous versions of this manuscript. Finally, I would like to express my gratitude to Bruno S. Frey for always encouraging me to pursue my ideas.

CONFLICT OF INTEREST STATEMENT

The author declares no conflicts of interest.

DATA AVAILABILITY STATEMENT

Data sharing is not applicable to this article as no datasets were generated or analyzed during the current study.

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How to cite this article: Follert, F. (2023). Learning from corporate governance: First conceptualization of a liability for political decision-making. *Kyklos*, 1–18. <https://doi.org/10.1111/kykl.12351>