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The apparently unstoppable growth of EC social regulation poses a difficult problem of explanation to the student of European integration. Some supranational regulation in the areas of competition, mergers, state subsidies, and the free movement of the factors of production is necessary for the proper functioning of the single European market, but the same cannot be said of social regulation. In fact, of the three most important fields of social regulation -- environment, consumer protection, and health, and safety at the workplace -- only the latter is explicitly mentioned in the Treaty of Rome, and then only as an area where the Commission should promote close coordination among the member states. Despite the lack of a clear legal basis, however, three Environmental Action Programmes were proposed by the Commission and approved by the Council of Ministers before the Single European Act formally recognized the competence of the Community in this area.

True, the first social regulatory measures were directly related to the free movement of goods: the harmonization of different health and safety standards of internationally traded products was meant to prevent the

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formation of non-tariff barriers. But quite soon the emphasis of EC social regulation shifted from product standards to process standards, and thus to positive regulatory objectives rather than the mere prevention of trade barriers.

Moreover, regulatory measures became increasingly ambitious, to the point that some recent directives exceed the standards of the most regulated member states. Now, according to intergovernmentalist theories, the quality of policy decisions in the EC is determined by the preferences of the least forthcoming government. Hence, barring special circumstances, regulatory outcomes should converge toward a least-common-denominator solution. From an intergovernmentalist perspective, policy innovation in the EC is a practical and theoretical impossibility.

Not even neo-functionalists, for all their interest in the leadership role of supranational institutions, thought it necessary to offer a theory of policy innovation at the European level. For them, the initial decision of governments to delegate policy-making powers, in a given sector, to a supranational institution inevitably creates pressures to expand the authority of that institution into neighbouring policy areas. But even neo-functionalists now admit that this prediction has been falsified. For example, although the Rome Treaty has a whole section on social policy, this field remains, and probably will continue to remain, under the control of the member states (it should be noted that even the Annex on social policy of the Maastricht Treaty is an intergovernmental agreement among the member states, with the exception of the United Kingdom).

In fact, in terms of traditional (i.e., redistributive) social policy, the Union remains a "welfare laggard". In environmental and consumer

protection, health and safety regulation, or equal rights for working men and women, however, European legislation has often gone beyond the level of protection provided by the majority of member states to their citizens. To what extent these regulatory measures are justified on efficiency grounds is an important issue, but not one with which this paper is immediately concerned. What the paper tries to explain is the willingness of the national governments to delegate such extensive regulatory powers outside the economic sphere, as well as the dynamics of the post-delegation phase.

Public-choice theorists have advanced persuasive explanations of the secular trend toward centralization that can be observed in many mature federal systems. Some of the causal factors identified by these scholars are clearly at work also in the European Community/European Union (EC/EU); for example, the interest of the European institutions in expanding the scope of their competences. Yet, caution is needed before one can extrapolate the results obtained for polities which already possess powerful federal institutions. In the European system, an intergovernmental body, the Council of Ministers, remains the ultimate legislator; hence the question about the willingness of the member states to delegate should be given an answer which takes the specific features of the EC system into account. Among these features is the fact that centralization has occurred in some fields, especially economic and social regulation, but not in others.

The explanation of such "selective centralization" suggested in this paper goes beyond the analysis of interests and rent-seeking behaviour, to consider different ways of structuring contractual arrangements (such as an

intergovernmental agreement or a EC directive) among self-interested actors with incomplete and asymmetric information. In this approach, derived from the work of authors like Coase, Oliver Williamson, and Milgrom and Roberts, the most interesting issues concern those motivational factors, such as mistrust and imperfect commitments, which increase the costs of transacting and prevent a satisfactory alignment of the interests of the various contractual partners. This analysis complements that of public-choice theorists, with the added advantage of providing a coherent intellectual basis for normative proposals.

1. Policy externalities and the dilemma of regulatory federalism

The increasing complexity of technology and society and the growing interdependence of national economies create a variety of unwanted side effects which economists have attempted to classify on a lengthening list of externalities. A negative externality exists when the action of one individual, one firm, or one government impose uncompensated costs on other individuals, firms, or governments. International externalities can be transmitted through natural environmental media, as in the case of transboundary air or water pollution, but also through trade. Thus, hazardous substances may cross national boundaries as ingredients or additives in a large number of internationally traded articles such as agricultural products, pesticides, pharmaceuticals, or fabrics that have been treated with carcinogenic substances.

When the trade flows from a producer in a heavily regulated country to countries that control neither imports nor domestic sale of hazardous

substances, the level of risk imposed on the citizens of the importing countries is largely determined by the regulatory policy of the exporting country. As this example shows, many international externalities (positive as well as negative) are created by the actions of national regulators, and it is with such "policy externalities" that this paper is concerned.

Notice that internationally relevant policy externalities can arise even in the case of purely local market failures. For instance, problems of safety regulation for construction of local buildings create no transboundary externalities and thus, according to the principle of subsidiarity, should be left to the local authorities. However, if safety regulations specify a particular material only produced in that locality, they amount to a trade barrier and thus have negative external effects. Hence, local regulation of a local market failure may create an international policy externality. Similarly, local authorities have sometimes controlled air pollution by requiring extremely tall smokestacks on industrial facilities. With tall stacks, by the time the emissions descend to ground level they are usually in the next city, region, or country, and so of no concern to the jurisdiction where they were emitted.

The strategic use of domestic regulation to gain advantages with respect to other countries or jurisdictions is a pervasive phenomenon. Because of the policy externalities it creates, every multi-level system of government faces a serious dilemma. Local governments may be more attuned to individual tastes, but they are unlikely to make a clear separation between providing public goods for their citizens and engaging in policies designed to advantage the locality at the expense of their neighbours.

Centralization of regulatory authority at a higher level of government can correct such policy externalities, and perhaps capture economies of scale in policy making. But its cost is the homogenization of policy across jurisdictions that may be dissimilar with respect to underlying tastes or needs.

There is no easy way of escaping this dilemma of regulatory federalism. Subsidiarity and mutual recognition -- to mention two principles often suggested as possible solutions in the context of the EC/EU -- address only one horn of the dilemma and do not face the issue of negative policy externalities. It would be equally plausible to argue that, because the integrated European market is such a new and still incomplete creation, the threat posed by the strategic use of regulation by national authorities is more serious than the danger of excessive and inefficient uniformity. As we shall see below, this argument is supported by a good deal of empirical evidence; but it would be wrong to jump to the conclusion that centralization is, if not an optimal at least a second-best solution. Under present institutional arrangements neither further centralization nor decentralization (in the sense of a re-nationalization of regulatory policy making) are acceptable alternatives. In the concluding section of this paper I suggest institutional reforms, both at the national and the European level, capable of mitigating, even if not resolving, the dilemma of regulatory federalism. Before making normative recommendations, however, several methodological and substantive issues have to be examined, beginning with the relation between externalities and transaction costs.

2. From negative externalities to transaction costs

We know from Coase theorem (Coase, 1960) that it is not externalities as such that constitute a problem for collective action, but positive transaction costs and imperfect information. In a situation where transaction costs are zero and information is complete, affected parties can always bargain among themselves to reach an efficient solution: either the externality is "internalized" by the emitter or, if the costs of eliminating it are greater than the benefits, the externality persists but is shown, ipso facto, to be a Pareto-irrelevant one.

The same argument, together with the usual assumptions of self-interested behaviour and bounded rationality, can be applied to problems of collective choice at the international level. Absent transaction costs and given perfect information, there would be no need for sovereign states to delegate regulatory powers to supranational or international bodies, or to harmonize their legislations. If national regulators were willing and able to take into account the external effects of their decisions; if they were well-informed about one another's intentions; and if the costs of organizing and implementing policy coordination were negligible, international externalities and other market failures could be managed by a series of bilateral agreements, or even by means of non-cooperative mechanisms such as retaliation or tit-for-tat strategies (Majone, 1994a).

Of course, such conditions are never satisfied in practice and most international agreements are accompanied by the creation of a secretariat to facilitate the exchange of information and reduce the costs of organizing cooperation. The powers delegated to European institutions are much

greater than this, however. In order to explain why member states have accepted such far reaching limitations of their sovereignty we must examine more closely the different kinds of transaction costs that arise in the formulation and implementation of international regulatory agreements.

In Coase's definition, transaction costs are incurred in order "to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on" (Coase, 1960, p.15). For our purposes it is necessary to adapt somewhat this definition and, at the same time, to take it a little further. A natural classification of transaction costs consistent with Coase's notion can be obtained from the different stages of the policy-making process: problem definition, agenda setting, policy formulation, implementation, evaluation.

Different transaction costs arise at the different stages since neither the nature of the task nor the set of policy actors remain constant throughout the process. Thus, under the power of legislative initiative granted to it by the Treaty of Rome, the European Commission is (in theory) the key actor at the early stages of policy making, while actual implementation of Community rules is largely under the control of national administrations. Simplifying, we can however group all transaction costs under three broad categories: search and information costs, bargaining and decision costs, policing, enforcement and measurement costs. As explained below, the third category is especially important for understanding the

willingness of the member states to delegate extensive regulatory powers to European institutions.

Particularly in the area of social regulation (environment, consumer protection, health and safety, equal rights for male and female workers) this delegation has gone well beyond the functional needs of a single European market. The trend toward centralized policy making is strikingly illustrated by the development of environmental regulation. In the two decades from 1967 to 1987, when the Single European Act acknowledged the competence of the Community to legislate in this area, well over 100 directives, regulations and decisions were introduced by the Commission and approved by the Council. Today, European environmental regulation includes more than 200 pieces of legislation. In many member states the corpus of environmental law of Community origin outweighs that of purely domestic origin (House of Lords, 1992). Moreover, while the first environmental directives were for the most part concerned with product regulation, and hence could be justified by the need to prevent that national standards would create non-tariff barriers to the free movement of goods, later directives increasingly stressed process regulation (emission and ambient quality standards, regulation of waste disposal and of land use, protection of flora and fauna, environmental impact assessments, and so on), aiming at environmental rather than free-trade objectives.

Such developments appear all the more surprising when one recalls that before the Treaty on European Union all environmental directives required unanimous approval by the Council of Ministers. Popular concern about environmental issues is not a satisfactory explanation since national

governments could have responded in a variety of ways to domestic demands for more environmental protection. In particular, environmental objectives could have been promoted through intergovernmental agreements as was done, for example, in case of the Agreement on social policy concluded between the member states, with the exception of the United Kingdom, and annexed to the Maastricht Treaty (Vogel-Polsky, 1994).

Coase theorem suggests that transaction costs may be one reason why member states chose instead to transfer regulatory powers to the supranational level. In fact, the problem with intergovernmental agreements (including policy coordination which, in the context of European institutions, means joint and interdependent actions without legal force: renegers cannot be taken to the European Court of Justice) is that it is often very difficult for the parties concerned to know whether or not an agreement is properly kept. Policing, enforcement and measurement costs are particularly significant in the case of environmental and other social regulatory measures. This is because of the difficulty of monitoring pollution, but also because of problems related to regulatory discretion and imperfect commitments. For example, measurement problems have played an important part in the conflict which opposed the United Kingdom to the other member states concerning the implementation of the 1976 Directive on pollution by dangerous substances. While most member states were willing to set uniform, Community-wide discharge standards, the implementation of which is fairly easy to monitor, the UK preferred to set environmental quality standards. Such standards are more sensitive to the different environmental circumstances of different countries but are also

much harder for outsiders to monitor. Hence the suspicion of the other member states that the U.K.'s preference for environmental quality standards was in fact due to an underlying unwillingness to implement its share of the agreement (Gatsios and Seabright, 1989).

Monitoring problems are compounded by regulatory discretion. Because regulators lack information that only regulated firms have and because governments are reluctant, for political reasons, to impose excessive costs on industry, bargaining is an essential feature of the process of regulatory enforcement. Regardless of what the law says, the process of regulation is not simply one where the regulators command and the regulated obey. A "market" is created in which bureaucrats and those subject to regulation bargain over the precise obligations of the latter (Peacock, 1984). Since bargaining is so pervasive, it may be difficult for an outside observer to determine whether the spirit, or only the letter, of an international regulation has been violated.

When it is difficult to observe whether national governments are making an honest effort to enforce a cooperative agreement, the agreement is not credible. Sometimes member states have problems of credibility not just in the eyes of each other but also in the eyes of third parties, such as regulated firms or governments outside the Union. For example, where pollution has international effects and fines impose significant competitive disadvantages on firms that compete internationally, firms are likely to believe that national regulators will be unwilling to prosecute them as rigorously if they determine the level of enforcement unilaterally rather than under supranational supervision. Hence the transfer of regulatory

powers to a supranational authority like the European Commission, by making more stringent regulation credible, may improve the behaviour of regulated firms. Because the Commission is involved in the regulation of a large number of firms throughout the Union, it has more to gain by being tough in any individual case than a national regulator; weak enforcement would destroy its credibility in the eyes of more firms (Gatsios and Seabright, 1989, pp.49-50).

3. The costs of mistrust

The costs of organizing, implementing and monitoring collective decisions are greatly increased if the parties to the agreement do not trust each other. In this section I argue that the mistrust of the member states toward each other and toward the European institutions, especially the Commission, has led to more centralization than is required by efficiency considerations, and risks undoing whatever advantages supranational regulatory delegation may possess.

The crucial importance of trust between public administrations is demonstrated by the failure of early attempts to harmonize national regulations for the approval of new medical drugs. The old EC procedure included a set of harmonized criteria for testing new products, and the mutual recognition of toxicological and clinical trials, provided they were conducted according to EC rules. In order to speed up the process of mutual recognition, a "multi-state drug application procedure" (MSAP) was introduced in 1975. Under the MSAP, a company that had received a marketing authorization from the regulatory agency of a Member State

could ask for mutual recognition of that approval by at least five other countries. The agencies of the countries nominated by the company had to approve or raise objections within 120 days. In case of objections, the Committee for Proprietary Medicinal Products (CPMP) -- a group which includes experts from member states and Commission representatives -- had to be notified. The CPMP would express its opinion within 60 days, and could be overruled by the national agency that had raised objections.

The procedure did not work well. Actual decision times were much longer than those prescribed by the 1975 Directive, and national regulators did not appear to be bound either by decisions of other regulatory bodies, or by the opinions of the CPMP. Because of these disappointing results, the procedure was revised in 1983. Now only two countries had to be nominated in order to be able to apply for a multi-state approval. But even the new procedure did not succeed in streamlining the approval process since national regulators continued to raise objections against each other almost routinely (Kaufer, 1990). These difficulties finally induced the Commission, with the support of the European pharmaceutical industry, to propose the establishment of a European Agency for the Evaluation of Medicinal Products and the creation of a new centralized Community procedure, compulsory for biotechnology products and certain types of veterinary medicines, and available on an optional basis for other products, leading to a Community authorization. Both the agency and the centralized procedure have been established by Council Regulation No 2309/93 of 22 July 1993.

In a recent paper on the political economy of centralization professor Vaubel examines several variables which may explain why most federal states have experienced a secular trend toward centralization. He shows that many influential political actors are interested in bringing about a more centralized system of government than is warranted on efficiency grounds: federal legislators, political executives and bureaucrats; federal judges; pressure groups representing regionally homonegeous interests; even politicians and bureaucrats at the lower levels of government, since expansion of the central government need not be at the expense of the lower-level governments (Vaubel, 1992). The example just given and many others that could be chosen from recent EC history, but also, say, from the experience of the American Confederation in the period 1781-1789, show that lack of trust and of "federal comity" (Bundestreue) among the member states should also be included in any satisfactory explanation of the trend toward greater centralization.

Member states not only mistrust each other; they also mistrust European institutions. This attitude has significant, if paradoxical, consequences both for the quantitative growth of Community regulations and for the poor level of their enforcement. One immediate consequence is that the Commission is kept on a very tight rein: it is chronically understaffed; closely monitored through an intricate system of "regulatory" and "management" committees which can block its proposals and transmit the file to the Council, which can overrule the Commission; and obliged to rely almost exclusively on the national bureaucracies for the implementation of the measures it elaborates.

Such drastic methods of control are only partially successful in limiting the regulatory discretion of the Commission (Majone, 1995) but produce several undesirable, and probably unanticipated, results. Consider first the budget constraint.

By national standards, the Community budget is quite small: less than 1.3 per cent of the gross domestic product of the Union or about 4 per cent of the combined expenditures of the central governments of the member states. It is also very rigid, since compulsory expenditures represent almost 70 per cent of the budget. These limited resources are insufficient to support large-scale initiatives in areas such as industrial policy, energy, transport or research and development, not to mention social policy or macroeconomic stabilization (Majone, 1993). However, the budget constraint has only a limited impact on regulatory activities, since the real costs of regulation are borne by the organizations and individuals who have to comply with it. Compared to these costs, the resources needed to produce the rules are negligible.

The structural difference between regulatory policies and policies involving the direct expenditure of public funds is especially important for the analysis of EC policy making since not only the financial, but also the political and administrative costs of implementing European rules are borne by the national administrations rather than the Commission. Thus, the attempt to restrict the scope of supranational policies by imposing a tight budget constraint has unwittingly favoured the expansion of a mode of policy making that is largely immune to budgetary discipline. Given the

constraint, regulation turned out to be the most effective way for the Commission to maximize its influence.

Moreover, by denying the Commission any significant role in implementation the member states have encouraged a tendency to focus on the quantitative growth of European legislation (so that, for example, the number of directives approved by the Council is viewed as an important indicator of success) rather than on effective compliance and actual results. Over-regulation cannot be blamed only on the Commission, however. Many regulations and directives are introduced at the demand of individual member states, the Council, the European Parliament, the Economic and Social Committee and a variety of private and public-interest groups, rather than by autonomous initiative of the Commission. While responsiveness to such demands may increase the legitimacy of the Commission, it also contributes to the apparently unstoppable growth of EC regulation.

Also the phenomenon of regulatory complexity may be usefully analyzed from the perspective suggested here. Many students of EC policy making have noted that Community directives usually contain many more technical details than comparable national legislation. The explanation that such regulatory complexity is due to the technical perfectionism of the Commission lacks plausibility: the Commission, as noted above, is chronically understaffed, has no in-house research capabilities, and is largely composed of generalists, not of technical experts.

Rather, regulatory complexity is in part another manifestation of the cascading effect of mutual distrust. Doubting the commitment of other governments to seriously implement European rules, and being usually

unfamiliar with different styles of administration, national representatives often insist on spelling out mutual obligations in the greatest possible detail. On the other hand, a vague and open-ended directive not only gives a member state wide latitude for wrongful or self-interested application, but also prevents the possibility of invoking it by an individual before a national court (Weiler, 1988). Thus, regulatory complexity may also serve the objectives of the Commission by providing partial compensation for its exclusion from the implementation process.

Also the labyrinthine system of committees of national experts, created to assist the Commission and at the same time to limit its discretion, favours regulatory complexity by introducing a strong technical bias into the Community regulatory process. In many cases, national experts have significantly increased the quality of Commission proposals (Weiler, 1988; Dehousse et al., 1992; Winter, 1993). In fact, what is known about the modus operandi of these committees suggests that debates there follow substantive rather than national lines. A good deal of copinage technocratique develops between Commission officials and national experts interested in problem solving rather than in defending national positions (Eichener, 1992). By the time a Commission proposal reaches the Council of Ministers all the technical details will have been worked out -- but little or no attention will have been paid to issues of cost-effectiveness or practical implementability. This technical bias, combined with the reluctance of the Council to engage in difficult and time-consuming policy control, and with the lack of central oversight at the Commission level, may be another factor contributing to regulatory complexity.

Empirical evidence on this point is scanty at best, but the hypothesis has some theoretical support. Some economists have argued that an explanation of regulatory complexity does not need to rest on the peculiar interests of the regulators but on the economic interests of third parties, namely, specialists in various aspects of regulation such as lawyers, accountants, engineers or safety experts. Unlike other interest groups, these experts care more about the process than the outcome of regulation. They have an interest in regulatory complexity because complexity increases the value of their expertise. Thus "red tape" may not be simply evidence of bureaucratic inefficiency or ineptness. Rather, in part, rule complexity is a private interest that arises because a complex regulatory environment allows for specialization in various stages of rule making, as well as in "rule intermediation" (Kearl, 1983; Quandt, 1983).

4. Digression on contractual incompleteness and EC directives

To appreciate the significance of the motivational factors discussed in the preceding section it is important to keep in mind the open-ended character of most Community acts, and of the founding treaties themselves. The most frequently used instrument of social regulation, the directive, is binding only "as to the results to be achieved" (Articles 189 of the EEC Treaty and 161 of the Euratom Treaty) but leaves "the choice of form and methods" to the national authorities. In other words, the directive lays down an objective and leaves it to the member states to achieve that objective according to such means as they see fit.

In a series of important cases (in particular the Van Duyn case in 1974) the European Court of Justice has attempted to reduce the uncertainty and increase the effectiveness of EC legislation by limiting the discretion of national governments in implementing Community directives. However, these attempts not only provoked negative reactions at the national level, but also tended to distort the structure of the founding treaties by blurring the distinction between directives and "regulations" -- acts which are directly applicable in all member states. At any rate, even after acknowledging, in theory, the principle of direct effect first stated by the Court in the Van Duyn case, the member states remained reluctant to accept interference with national administrative arrangements for implementation.

One of the sources of uncertainty, hence of transaction costs, associated with implementation of Community directives is the differing structural character of the legislation that has been agreed. As Macrory (1992, pp.348-349) writes, "[s]ome directives prescribe explicit and precise goals that must be achieved in a given sector which in theory should be reasonably straightforward to monitor and enforce. Another class contains similarly precise goals within specified actors or areas but leaves a large element of discretion to Member States in determining where they are to apply". Moreover, what is actually implied by the concept of "implementation" is by no means cut and dried (ib., p.352).

The open-ended character of directives suggests that these Community acts (and perhaps also other instruments of the "soft law" variety) may be usefully modeled as "incomplete contracts" between the

European executive and the member states. The theory of incomplete contracting occupies a central position in the new economics of organization and in the positive theory of institutions (Williamson, 1985; Eggertsson, 1990; Kreps, 1990; North, 1990; and Milgrom and Roberts, 1992, on which the following summary is largely based).

Keeping in mind that in the language of the new institutionalism a contract is any agreement (not necessarily legally binding) among actors who recognize their mutual interests and agree to modify their behaviour in ways that are mutually beneficial, it is easy to see that a complete contract could solve the motivation problem of collective action. Motivation questions arise because contractual partners have their own private interests, which are rarely aligned with the interests of other partners or of the organization to which the partners belong. Because of this misalignment, contractual partners do not act as they are supposed to act in order to carry out the contract. Now, a complete contract would specify precisely what each partner is supposed to do in every possible circumstance, and arrange the distribution of the benefits and costs realized in each contingency so that each partner individually finds it convenient to abide by the contract's terms. Thus, the motivation problem would be solved.

However, complete contracting requires, inter alia, that the partners be able to foresee and accurately describe all the relevant contingencies that might arise in the course of the contract, and that they be willing and able to agree upon an efficient course of action for each possible contingency. Also, each partner should be able to determine whether the

contract's terms are being met and, if they are violated, to enforce the agreement. Such requirements are never satisfied in actual contracting because of a combination of factors: bounded rationality, opportunistic behaviour (including the possibility of reneging) and imperfect commitments.

One possible contractual response to these constraints is to write inflexible contracts with blanket provisions that are to apply very broadly. The practice of Community institutions of enacting directives with provisions every bit as detailed and precise as those found in a regulation (Hartley, 1988, p.206) may be interpreted as such a response. However, as noted above, to blur the distinction between directives and regulations is to distort the structure of the founding treaties. More generally, an inflexible specification of the actions to be taken is likely to be too unresponsive to changing conditions. Hence inflexible agreements are an efficient method of contractual governance only for relatively simple, once-for-all transactions such as the so-called spot-market contracts.

A more promising response to contractual incompleteness is relational contracting, which does not attempt the impossible task of complete contracting but instead settles for an agreement that frames the entire relationship. This mode of contractual governance recognizes that it is impossible to concentrate all of the relevant bargaining action at the ex ante contracting stage. The same point was made in section 2 above, where it was argued that bargaining is not limited to the initial stages of regulatory policy making (problem definition, agenda setting and policy

formulation), but is also an essential feature of the process of regulatory enforcement.

Under relational contracting the parties "do not agree on detailed plans of action but on goals and objectives, on general provisions that are broadly applicable, on the criteria to be used in deciding what to do when unforeseen circumstances arise, and on who has what power to act and the bounds limiting the range of actions that can be taken, and on dispute resolution mechanisms to be used if disagreements occur" (Milgrom and Roberts, 1992, p.131). It may be argued, though the point will not be further developed here, that the original concept of the European directive, as it appears in the founding treaties, is quite close to the philosophy of relational contracting, while attempts to erase the difference between directives and regulations represent a misguided response to the problems of contractual incompleteness. Be that as it may, it is suggested that students of EC policy making can learn a great deal from recent theories on the governance of contractual relations.

5. The European Commission as policy entrepreneur

The argument developed so far may be summarized by saying that, in order to explain the assignment to the supranational level of greater regulatory powers than would be required by efficiency considerations, one must consider also the motivation issue -- the imperfect alignment of national interests with the interests of the Union, and the transaction costs this entails. The delegation of extensive powers of adjudication and policy making to supranational institutions is what distinguishes the EC/EU from

more traditional international organizations. To understand the quantitative and qualitative growth of European social regulation, however, it is equally important to analyze the post-delegation phase.

The thrust of much recent research on political-bureaucratic relations is that bureaucracy has a substantial degree of autonomy, and that direct political control is rather weak (Wilson, 1980; Moe, 1987, 1990; Majone, 1994c). Oversight for purposes of serious policy control is time-consuming, costly, and difficult to do well under conditions of uncertainty and complexity. At any rate, legislators are concerned more with satisfying voters to increase the probability of re-election than with overseeing the bureaucracy. As a result, they do not typically invest their scarce resources in general policy control. Instead, they prefer to intervene quickly, inexpensively and in ad hoc ways to protect particular clients in particular matters (Mayhew, 1974). Hence legislative oversight is un-coordinated and fragmented. Similarly, the literature on the budgetary process has cast doubts on the budget as an effective tool of control. As Wildavsky (1964) discovered, budgeting is decentralized and incremental, resulting in automatic increases that further insulate the bureaucracy from political control.

Theories based on the principal-agent model give a more positive assessment of the possibility of political control of the bureaucracy. According to agency theory, political control is possible because elected politicians can design administrative institutions with incentive structures to facilitate control (Wood and Waterman, 1991, p.803). It is certainly true that in the delegation phase political principals have the freedom to select

their agents and impose an incentive structure on their behaviour. Over time, however, bureaucrats accumulate job-specific expertise, and this "asset specificity" (Williamson, 1985) alters the original relationship. Now politicians must deal with agents they once selected, and in these dealings the bureaucrats have an advantage in technical and operational expertise. As a result, they are increasingly able to pursue their objective of greater autonomy. As Terry Moe (1990, p.143) writes:

> Once an agency is created, the political world becomes a different place. Agency bureaucrats are now political actors in their own right: they have career and institutional interests that may not be entirely congruent with their formal missions, and they have powerful resources -- expertise and delegated authority -- that might be employed toward these "selfish" ends. They are now players whose interests and resources alter the political game.

This recent research on political-bureaucratic relations throws considerable light on the dynamics of delegation and control in the EC context. Also for the representatives of the member states in the Council of Ministers oversight for purposes of serious policy control is costly, time-consuming, and difficult to do well. Hence their unwillingness to invest scarce resources in such activities. As was mentioned in Section 3, the "comitology" system is an attempt to control the Commission's discretion in the execution of Council directives. Regulatory and management committees created under this system can block a Commission measure and transmit the case to the Council, which can overrule the Commission. Even in the case of such committees, however, the Commission is not only in

the chair, but has a strong presumption in its favour (Ludlow, 1991, p.107). According to the most detailed empirical study of the comitology system to-date "Commission officials generally do not think that their committee significantly reduced the Commission's freedom and even less that it has been set up to assure the Member States' control" (Institut für Europäische Politik, 1989, p.9). According to the same study, the Council acts only rarely on the complex technical matters dealt with by the comitology committees, but when it does, its decisions mostly support the Commission's original proposals (ib., p.123).

In fact, the Council cannot compete with the expertise at the disposal of the Commission and its Directorates (Peters, 1992, p.119). The offices of the Commission responsible for a particular policy area form the central node of a vast "issue network" which includes, in addition to experts from the national administrations, independent experts, academics, consumer and other public-interest advocates, and representatives of economic interests, professional organizations and sub-national governments. Commission officials engage in extensive discussions with all these actors but remain free to choose whose ideas and proposals to adopt. The variety of policy positions, which is typically much greater than at the national level, increases the freedom of choice of European officials. It may even happen that national experts find the Commission a more receptive forum for new ideas than their own administration. A significant piece of safety regulation, the 1989 Machinery Directive (89/392/EEC) offers a striking example of this. The crucially important technical annex of the directive was drafted by a British labour expert who originally had sought to reform

the British approach to safety at the workplace. Having failed to persuade the policy makers of his own country, he brought his innovative ideas to Brussels, where they were welcomed by Commission officials and eventually become European law (Eichener, 1992, p.52).

Thus, despite all the limitations imposed by the member states, the Commission is often able to play the role of a policy entrepreneur. Policy entrepreneurs are constantly on the look out for windows of opportunity through which to push their preferred ideas. Policy windows open on those relatively infrequent occasions when three usually separate process streams -- problems, politics, and policy ideas -- come together. Policy entrepreneurs concerned about a particular problem search for solutions in the stream of policy ideas to couple to their problem, then try to take advantage of political receptivity at certain points in time to push the package of problem and solution (Kingdon, 1984). This is precisely what happened in the case of the Machinery Directive mentioned above (Eichener, 1992) and in several other instances (Dehousse and Majone, 1994).

A successful policy entrepreneur possesses three basic qualities: first, he must be taken seriously either as an expert, as a leader of a powerful interest group, or as an authoritative decision maker; second, he must be known for his political connections or negotiating skills; third, and probably most important, successful entrepreneurs are persistent (Kingdon, 1984, pp.189-90). Because of the way they are recruited, the structure of their career incentives, and their crucial role in policy initiation,

Commission officials often display the qualities of a successful policy entrepreneur to a degree unmatched by national civil servants.

In particular, the Commission exhibits the virtue of persistence to an extraordinary degree. Most important policy innovations in the EC have been achieved after many years during which the Commission persisted in its attempts to "soften up" the opposition of the member states, while waiting for a window of opportunity to open. A textbook example is the case of the Merger Control Regulation approved by the Council on December 21, 1989, after more than 20 years of political wrangling (Majone, 1995).

Another strategy used by policy entrepreneurs consists in introducing a new dimension to the policy debate. By changing the nature of the debate, an entrepreneur may be able to break up existing equilibria and create new and more profitable policy outcomes. The successful entrepreneur, according to Riker (1986, p.64) "probes until he finds some new alternative, some new dimension that strikes a spark in the preferences of others". An example of this strategy is the Commission's advocacy of the concept of "working environment". This concept opens up the possibility of regulatory interventions in areas traditionally considered to be outside the field of health and safety at work, such as stress and fatigue. The above-mentioned Directive 89/392 and also Directive 90/270 on health and safety for work with display screen equipment, are inspired by this regulatory philosophy.

In view of the claim often made by students of EC policy making, that Community policies are under the control of the most powerful

member states, it should be pointed out that these directives extend to the European level the approach of two small countries -- Denmark and the Netherlands, which first introduced the concept of working environment into their legislation -- and were opposed by Germany in order to preserve the power and traditional approach of its own regulatory bodies (Feldhoff, 1992; Eichener, 1992).

It is no coincidence that the best examples of policy entrepreneurship at the EC level are in the field of social regulation. The reason becomes clear if one recalls James Q.Wilson's well-known classification of the politics of different policy fields (Wilson, 1980, pp.366-372). The classification is structured according to the perceived distribution of the benefits and costs of a proposed policy, as shown in the following table:

Costs \ Benefits	Diffuse	Concentrated
Diffuse	Majoritarian Politics	Client Politics
Concentrated	Entrepreneurial Politics	Interest-group Politics

When both costs and benefits are widely distributed (e.g., social security, national health care, education) interest groups have little incentive to form around such issues since no identifiable segment of society can expect to capture a disproportionate share of the benefits or to avoid a disproportionate share of the costs. Hence, such issues are dealt with in the traditional arena of majoritarian politics. In the European context this means that the issues are dealt with at the national rather than at the supranational level. This explains why traditional social policy remains largely under the control of the member states.

When both costs and benefits are concentrated, each side has a strong incentive to organize and exercise political influence. EC structural policy is a pertinent example. Although the structural funds aid some industrially declining regions in the wealthier countries, the overall effect of the policy is to transfer resources from one well defined group of contributing countries to another, equally well defined group of receiving countries. As this example suggests, the European analogue of interest-group politics is intergovernmental bargaining between two (or more) groups of countries.

When the benefits of a prospective policy are concentrated while the costs are widely distributed, small, easily organized groups (such as oligopolistic firms in the automobile, electronics, chemical or pharmaceutical industries) have powerful incentives to lobby in order to obtain favourable legislation at the national or, increasingly, at the European level. On the other hand, consumers have little incentive to organize since the costs of the regulation are low on a per capita basis. The label "client politics" for this particular configuration of costs and benefits

suggests the possibility that the regulators become captured by the regulated interests.

Finally, a policy may confer general (though perhaps small) benefits at a cost to be borne chiefly by a small segment of society. Most social regulation falls into this category. The costs of cleaner air and water, safer products, and better working conditions are borne, at least initially, by particular segments of industry. Since the incentive to organize is strong for the opponents of the policy but weak for the beneficiaries, social regulatory measures can be passed only if there is a policy entrepreneur who can mobilize public sentiment (by capitalizing on crises like the Seveso or Tchernobyl disasters), put the opponents of the regulatory measures on the defensive, and associate the legislation with widely shared values -- clean air and water, health and safety, equal rights for men and women.

According to Wilson, the policy entrepreneur "serves as the vicarious representative of groups not directly part of the legislative process" (ib., p.370). This observation helps to explain the growing significance of social regulation at the European level. At the national level, social regulation plays a politically less important role than macroeconomic or redistributive social policy. The most powerful political coalitions still form around issues of redistribution and macroeconomic management. The resulting policies tend to favour producers -- managers, unionized workers, organized professionals -- at the expense of consumers. Moreover, political systems characterized by party control of both executive and legislature, highly centralized public bureaucracies and weak judicial review do not leave much room for either the direct representation of diffuse interests or

the emergence of independent policy entrepreneurs. In this respect, Germany is the (partial) exception which confirms the rule.

The situation is very different at the European level. Here the redistributive function of government is severely limited by the small size of the budget, and the macroeconomic function almost non-existent; redistributive coalitions and corporatist networks are correspondingly weak. Again, agriculture is the exception that confirms the rule (the case of regional aid is different: these transfers can perhaps be viewed as incentive-efficient mechanisms in the sense of Milgrom and Roberts (1992), that is, as a way of overcoming the resistance of some member states to efficiency-enhancing policies such as the completion of the internal market). In this situation, the insulation of the Commission from partisan politics and the electoral cycle, the activism of the Court of Justice, and the interest of the European Parliament in finding a distinctive role for itself, are all factors that explain why diffuse interest are often better represented at the European than at the national level, and why political entrepreneurship is an important feature of European policy making. Notice the apparent paradox: the same supranational institutions so often criticized for their alleged "democratic deficit" are at the same time the advocates of diffuse interests that do not find adequate expression in the national political systems.

6. Normative conclusions

The preceding pages should have made clear that centralization of regulatory authority at the supranational level is one way, though not

necessarily the best way, of correcting policy externalities and reducing transaction costs. It has also been argued that the level of centralization can be explained in part by the mutual distrust of the member states and the justified suspicion that national governments may use regulation to promote their own interests rather than the aggregate welfare of the Union. However, to juxtapose the national and supranational levels as if they were the only possible solutions of the dilemma of regulatory federalism -- the trade-off between local preferences and policy externalities -- is not only to push simplification beyond the limit of heuristic usefulness, but also to overlook promising possibilities of institutional reform.

To begin with, it should be noticed that the optimal assignment of regulatory responsibilities among different levels of governments need not coincide with existing jurisdictional boundaries. There may be significant externalities and a need for joint action between some, but not all, regions within a country or group of countries. Hence the optimal solution may be found neither at the European nor at the national level, but at some intermediate level comprising a group of states (or regions within different states) facing the same problem; the scope of the externality would determine the membership of the group. Self-regulating organizations encompassing several states ("regional compacts", such as the Delaware River Basin Commission) have been used in the United States since the 1960s and in some cases even earlier (Derthick, 1974). More recently, institutional arrangements encompassing American states and Canadian provinces have been created in order to control pollution in the Great Lakes regions.

By pooling their financial, technical and administrative resources these consortia of states or regions are in a better position to deal satisfactorily with their regulatory problems than either by acting alone or by relying exclusively on centralized regulation which cannot be closely tailored to their specific needs. The "regional compact" model combines flexibility with economies of scale in policy formation and implementation. Its adoption on this side of the Atlantic would have far-reaching consequences for the future of European regulation. Instead of the traditional dichotomy of centralized or national regulation, with its artificial separation of rule making from enforcement, we would have a small regulatory body at the European level. Among the tasks of this body would be providing technical and administrative assistance, facilitating the diffusion of ideas and policy innovations, and acting as "regulator of last resort" where regional regulators failed to achieve their objectives. At present, a few environmental directives allow member states to set regionally differentiated standards in zones designated by them in accordance with Community guidelines. The model suggested here goes well beyond these timid attempts to tailor regulation to the specific needs of different regions of Europe.

Second, the main potential advantage of centralizing regulation at the European level -- the reduction of transaction costs due to the mutual distrust and self-interested behaviour of the member states -- is seriously compromised by a system of governance which, with a few exceptions, leaves implementation in the hands of the member states. This artificial separation of rule-making and rule-enforcement goes against everything we

know about the theory and the practice of policy making. Some of its negative consequences have been analyzed by Fritz Scharpf in a well-known paper very appropriately titled "The Joint-Decision Trap" (Scharpf, 1988).

Policy analysts point out that implementation is not a separable stage of policy making but rather, to paraphrase von Clausewitz, the continuation of policy formulation by other means (Majone and Wildavsky, 1979). The logic of relational contracting points in the same direction. As mentioned in section 4, the starting point of the relational-contracting approach is the observation that it is impossible to concentrate all of the relevant bargaining action and discretionary choices at the ex ante contracting stage. As Williamson, quoting I.R.MacNeil, writes, the fiction of the discreetness of the ex ante and ex post stages must be abandoned as the relation among contractual partners takes on the characteristics of a "minisociety with a vast array of norms beyond those centered on the exchange and its immediate processes". By contrast with the traditional view of contract, according to which the reference point for effecting adaptations remains the original agreement, the reference point under a relational approach is the "entire relation as it has developed [through] time. This may or may not include an "original agreement"; and if it does, may or may not result in great deference being given it" (Williamson, 1985, pp.71-72).

What all this means for European policy making is that the present structure of divided governance should be replaced by a system where the need for joint action is examined much more critically than in the past; but where, once the need is established, the European institutions are given

responsibility, as well as the requisite authority, for ensuring that joint decisions are effectively implemented. Member states are beginning to realize that non-compliance threatens the credibility of their collective decisions. The European Council meeting at Dublin in June 1990 first gave the issue of non-compliance a high political profile in its final declaration.

In October 1991 the Council of Environmental Ministers held an informal meeting on implementation, as a result of which the Commission was instructed to submit proposals concerning the further development of policy on compliance and enforcement. At the Maastricht summit the member states again stressed the need for Community legislation to be accurately transposed into national law and effectively applied, while the Treaty on European Union (Maastricht Treaty) contains new powers for the European Court of Justice under which it may fine member states which fail to comply with the judgments of the Court. The Intergovernmental Conference on institutional reform, scheduled to begin in 1996, ought to take this consensus on the crucial importance of compliance as a starting point to re-assess the logic of the entire process of policy making in the EC. Our analysis suggests that institutional reform should not be limited to the European level, but should squarely face the motivation question -- how to abate mistrust, obtain credible commitments, and achieve a better alignment of interests -- at all levels of government.

Now, the main source of mutual distrust and poor credibility is, arguably, the suspicion that national and subnational governments may use their legal and policy instruments to pursue short-term political advantages rather than jointly agreed regulatory objectives. The consequences, as we

saw, are more centralization and greater uniformity of norms than is necessary for market integration. Under the present institutional arrangements, however, a plea for more decentralization and greater normative flexibility is easily seen as an open invitation to grant further discretionary powers to the member states thereby placing market integration in jeopardy.

One way out of this dilemma is to grant more independence to national, subnational, and supranational regulators, so that their commitment to a set of objectives decided at the European level is not compromised by domestic political considerations or by ministerial interference. Independence changes the motivation of regulators whose reputation now depends more on their ability to achieve the objectives assigned to their agencies than on their political skills. With independence, a problem-solving style of policy making tends to replace the more traditional bargaining style. Also, it is not difficult to show that greater independence implies more, rather than less, public accountability (Majone, 1994b).

By now, the independence of central banks enjoys widespread political support in most countries of Europe. Even the Treaty of Maastricht, although generally opposed to further delegation of policy making powers to the supranational level, assigns sweeping powers to the European Central Bank (ECB). The ECB can make regulations that are binding in their entirety and become European and member states' law, without the involvement of the Council or of national parliaments. The Bank has a single objective, monetary stability, and the freedom to pursue

this objective in complete independence of the other European institutions and of the national governments. Moreover, since the governors of the central banks of the member states are members of the ECB Council, they too must be insulated from domestic political influences in the performance of their task; they can no longer be players in the old game of pumping up the economy just before an election (Nicoll, 1993).

The recent rise of independent regulatory agencies throughout Europe (Majone, 1994d) shows that the perceived advantages of independence -- professionalism, accountability by results, freedom from party political influence, greater policy continuity -- are not confined to central banks. While these advantages are acknowledged in theory, however, old habits of ministerial interference continue to persist in practice. Government departments still preserve important regulatory powers so that the operations of agencies often are dependent on prior decisions of the minister laying down the principles to be applied. But the credibility of regulators will continue to remain low as long as agency autonomy can be disregarded with impunity in the name of short-term political considerations.

It will probably take some time before politicians in Europe become convinced, like their colleagues in America, that it is in their long-term interest to respect the independence of regulatory agencies, just as they respect the independence of the courts. In the meantime, measures should be taken to strengthen the position of national regulators, and here the European Union can play a useful role.

Credibility can be developed through team work. Although people may be weak on their own, they can build resolve by forming a group (Dixit and Nalebuff, 1991). The same is true of organizations. A regulatory agency which sees itself as part of an international network of institutions pursuing similar objectives and facing analogous problems, rather than as a new and often marginal addition to a huge national bureaucracy, is more motivated to resist political pressures. This is because the regulator has an incentive to maintain his or her reputation in the eyes of fellow regulators in other countries. A politically motivated decision would compromise his/her international credibility and make cooperation more difficult to achieve in the future.

The European Commission should take the lead in facilitating and coordinating the work of EU regulatory networks, and in ensuring that their activities are consistent with European objectives. The network model is perhaps easiest to visualize in the field of competition. An over-worked and under-staffed DG IV has already advocated a move toward a decentralized system of enforcement via proceedings before national courts. However, it has been rightly pointed out that it would make more sense to transfer responsibility for enforcement to the national competition authorities than to national courts and private litigants. These authorities perform a role which is analogous to that of DG IV, and they possess the kind of experience and expertise which courts of ordinary jurisdiction often lack. Moreover, there already exist direct links between Commission inspectors and national competition authorities as regards any investigations carried out by the Commission. In fact, under Regulation 17, the relevant national

competition authority must be associated with inquiries and investigations, and its officials must be present if a search of premises is carried out (Harding, 1994, pp.7-9).

There is no reason why the network model could not be extended to other areas of economic and social regulation. In fact, at an informal meeting of the Council of Ministers in October 1991, it was agreed that member states should establish an informal network of national enforcement officers concerned with environmental law. The recent creation of a number of European agencies (mostly in the field of social regulation) may be seen as a further move in this direction. However, the logic of the model suggests that not only national regulators but also their counterparts in the Commission should be independent. Although European commissioners are not supposed to pursue national interests, usually they are politicians who, after leaving Brussels, will continue their careers at home. This makes national pressures often difficult to resist. In a number of well-publicized cases, such pressures have produced flawed or at least inconsistent decision. Again, competition policy, including the control of mergers and of anti-competitive state aid, provides the clearest examples. Several analysts have argued that European will never have a coherent competition policy without a cartel office independent both from the national governments and from the Commission. Commissioners would still be able to reverse an independent agency's decisions, as the German government does in the case of some Bundeskartellamt's rulings. But the political costs of doing so would be high, and the interference plain for all to see.

Trans-national regulatory networks, like the "regional compact" model discussed above, represent in my opinion promising ways of dealing with the dilemma of regulatory federalism. Naturally, they raise a number of practical and conceptual issues, the most important of which is democratic accountability. The accountability problem is too complex to be discussed here. I can only refer the interested reader to another publication (Majone, 1994b) where I argue that independence and accountability can be complementary and mutually reinforcing rather than antithetical values. What is required to reconcile independence and accountability are richer and more flexible forms of control than the traditional methods of political and administrative oversight.

Clear and limited statutory objectives, strict procedural requirements like those imposed on American regulators by the Administrative Procedures Act, judicial review, cost-benefit analysis and the "regulatory budget", professionalism and expertise, monitoring by interest groups, even inter-agency rivalry, can all be elements of a pervasive but flexible system of control. When the system works properly no one controls an independent agency, yet the agency is "under control".

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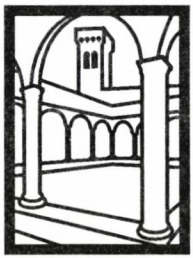

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