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Re-examining the Principal-Agent model in the realm of EU external relations

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Abstract

The Principal-Agent model has served as the basis for an extensive research agenda in examining matters of delegation between the Council and the Commission in the realm of EU external relations. Yet despite the increasing number of studies, there has been made little attempt to examine the basic assumptions of the P-A model. The two main assumptions are: (i) the preferences between the principal and the agent are opposed resulting in goal conflict and (ii) the agent possesses more information than its principal leading to an information asymmetry. The question, which arises, is if these assumptions hold in every political context? Can they vary and what would be the implication of such variation? This study attempts to provide a critique of the P-A model by extending the notion of contract and hence re-conceptualizing the contractual relationship between the Council and the Commission.

Keywords: P-A model, goal conflict, information asymmetry, relational contracting, EU external relations

Introduction

“ Contract without the common needs and tastes created only by society is inconceivable; contract between totally isolated, utility maximizing individuals is not contract, but war” (MacNeil, 1980)

The relationship between the Council and the Commission with regard to external policies has been extensively examined over the last years by the Principal-Agent approach which has become the dominant model in examining matters of delegation and the functioning of formal control mechanisms in inter-institutional EU settings (Pollack 1997; Nicolaidis and Meunier 1999; Franchino 2000; Majone 2001; Pollack and ebrary 2003; Franchino 2004; Meunier 2005; Delreux 2008). Despite the plethora of P-A studies, which have been employed in the domain of EU external relations most do not address directly the terminology and assumptions of the Principal-agent approach. The two critical assumptions with which the P-A model works is *preference divergence (i.e. goal conflict)* between the principal and the agent and a high degree of *information asymmetry*. It is due to preference divergence that the agent has an interest to act opportunistically and it is through information asymmetries that he acquires the potential to do so, resulting in the so-called agency problem. Hence the function of the contract between a principal and an agent is to create a contract of enforceability to remedy the occurrence of the agency problem.

In contrast to the P-A approach ‘relational contracting’ argues in favor of a different contractual pattern (Macneil 1980). While enforceability may be an integral part of contracts it does not capture adequately the modus operandi of contracting (ibid.). Contracts are there primarily for the sake of cooperation; it is first about exchange and second about enforceability. The contract is seen in that respect as an ongoing dynamic state of relations among partners (Macneil 1973). Relational contracting does not assume a priori goal conflict between the principal and the agent but rather favors a process of preference formation. Hence preferences are not seen as a constant but rather as something dynamic emerging from the values and agreed-upon processes found in social relationships (Poppo and Zenger 2002). The contract becomes in that sense the relation itself which in many cases might lead to preference convergence among the partners, especially in contexts of repeated exchanges (Macneil 1980). This study aims to critically examine P-A assumptions of goal conflict and information asymmetries between the Council and the Commission in the domain of EU external relations. It is argued that P-A’s assumptions should not be taken as constants but rather treated as variables. This leads subsequently to a re-interpretation of how contractual safeguards function between the Commission and the Council arguing in favor of less formal control mechanisms and instead of common and shared norms.

The paper proceeds as follows. *Section I* provides a short description of the principal-agent approach underlying its main assumptions and methodological tools with regard to the agency problem. The section proceeds in illustrating the conceptual shortcomings of the P-A approach in defining contractual arrangements offering an alternative explanatory approach, namely relational contracting. *Section II* proceeds with applying the insights of relational contracting to the realm of EU external relations, emphasizing the importance of structural elements such as EU case law, the institutional design of the article 218 TFEU procedure and the Committee system in shaping the contractual arrangement between the Council and the Commission. This contractual arrangement, which is more oriented towards cooperation than goal conflict, will have ultimately an impact of how control mechanisms are exercised in EU external relations between the Council and the Commission, emphasizing the importance of social norms.

I. The conceptualization of ‘contract’ in P-A theory and relational contracting

The P-A model has as its unit of analysis a contract between a principal and an agent. In the P-A model all contract schemes are premised upon a strict functional division of decision making functions in which a principal occupies decision control functions (i.e. ratification and monitoring of decisions) whereas an agent is responsible for decision management (i.e. initiation and implementation)(Fama and Jensen 1983). The P-A problem refers to a situation in which the agent might if not appropriately checked by the principal act opportunistically. The latter manifests itself in agency slacking which can take two forms: shirking that is the agent minimizes the effort it exerts on its principal behalf and slippage when the agent shifts policy away from its principal’s preferred outcome and toward its own preferences (Hawkins 2006). In consequence the principal as the risk bearer has to design the contract in such a way as to protect his interests and assure that the agent’s behavior is in line with the prescribed guidelines of the contract. The more discretionary authority the agent acquires, the more potential there is for opportunistic behavior, the more risk the principal has to bear and the more complex a contract becomes. However no contract can be guaranteed perfectly and without costs. Bounded rationality limits them to write a contract, which would count for all potentially occurring eventualities. Therefore they are left with the use of an incomplete contract. The latter manifests itself in information asymmetries between the principal and the agent. In managing these information asymmetries the principal installs a variety of contractual safeguards in the form of either police patrols or fire alarms¹.

The P-A model considers that the underlying behavior of an agent is always expected to be opportunistic (and therefore somehow ‘negative’) and this agency problem can be mitigated by the appropriate installment of legal control mechanisms. In that regard enforceability plays the central role in P-A’s conceptualization of a contract. While enforceability is definitely an important aspect it is just an element among many. A contract entails both power-checking and power-enabling elements. In organization theory and in particular relational contracting, the contract between two parties is seen from a more positive perspective. The contract is rather used to create conditions that motivate actors to achieve desirable outcomes. Contracting in that sense serves more as a power-enabling process in creating the conditions of cooperation among institutions; its more about getting things done by pursuing mutually beneficial outcomes. This conception suggests that managing the agency problem is only part of the equation. Tomkins (2001:177) writes in that regard “ the major value of contracting may lie in it being a device to set down goals and methods to enable mutual planning, rather than being primarily and ex-post control device”.

The P-A approach relies on two critical assumptions: (i) preference divergence manifested in goal conflict between the principal and the agent and (ii) information asymmetries. These two assumptions are treated as constants throughout the model. There is virtually given no consideration to social structure and its impact upon goal conflict and information asymmetries. In that regard the P-A approach relies entirely on a discrete kind of contract characterized by superior-subordinate dyads, which are cut-off from their environment in a way that exchanges are separated from all else between the participants (Macneil 1980). In contrast relational contracting emphasizes the importance of the social structure in which a contract is embedded. The contract should not be seen as static but rather as something dynamic emerging from the values and agreed-upon processes found in social relationships (Poppo and Zenger 2002). Hence the P-A assumptions should be treated as variables that can change over time; preference convergence is achievable in relational contracting within the context of cooperation. Furthermore whereas the P-A approach uncritically assumes goal conflict by which benefits and burdens are sharply divided and each actor operating within a zero sum context tries to maximize his benefits at the expense of the other, relational contracting emphasizes the importance of institutional structure, which can lead to positive pay-off outcomes for the same actors. In consequence whereas the P-A approach takes divisiveness and institutional rivalry for granted, relational contracting emphasizes the cooperative and coherent aspects of inter-institutional exchanges.

The second critical assumption of the P-A model is the claim that agents possess more information than their principals do. Information asymmetries are treated in that respect as a constant, an a priori condition that can only be remedied by the installment of appropriate control mechanisms. However the dissemination of information among institutions is highly dependent on the institutional structure which regulates inter-institutional communication. It is the latter, which determines if information asymmetries remain high or tend to be reduced via information sharing and open

communication throughout the policy process. Furthermore the P-A model is characterized by an inherent contradiction with regard to information asymmetries. Although the model relies on the assumption of bounded rationality the Principal can nevertheless a priori calculate which control mechanisms are appropriate in the post-contract stage given that in all other respects they are the victims of information asymmetries. This contradiction is related to MacNeil's (1980) problem of 'presentation'. The latter refers to an unrealistic approach by which all future-related exchanges are brought into the present; it deals then with the future as if it were the present. In relational contracting information asymmetries operate as a variable which is assessed not within a particular point in time but within the entire time horizon of a contract relation.

II. The P-A model in EU external relations

There is an increasing number of P-A studies in the realm of EU external relations (Nicolaidis and Meunier 1999; Meunier 2000; Meunier and Nicolaidis 2000; Pollack and ebrary 2003; Meunier 2005; Tallberg, Jorgensen et al. 2007; Delreux 2008). These studies though have paid little attention to P-A's critical assumptions, taking for granted that they apply in external relations. However the application of the P-A model should be assessed against the background of the actual working of contracts between the Council and the Commission in treaty-based regulatory regimes. One must frankly recognize that a contract in such contexts has to fulfill both negative (power checking) and affirmative (power directing) functions. The political P-A model has been developed exclusively within an US domestic political context for regulating legislative-executive relations between Congress and regulatory agencies. In contrast EU executive politics in the realm of external relations which is characterized by the functioning of a dual executive (i.e. Council and Commission) can be subject to a very different contract logic. Basic contract components for instance of U.S. federal administrative law which are contained in the Administrative Procedure Act (APA) such as procedural requirements for agency decision-making, threshold requirements for the availability of judicial review, principles defining the scope of judicial review, and provisions regarding public access to agency information are not equally applicable to treaty based regulatory regimes. The imperatives in external relations are of a different kind; traditional diplomatic norms of secrecy and confidentiality as well as a highly competitive environment among nation states often favor the use of informal models and cooperative arrangements. In consequence contexts differ and one has to be careful in treating all political relationships as a cauldron of conflict. The social structure which the P-A model largely ignores plays an important role in influencing preference formation and information availability between the Commission and the Council. In particular (i) law, (ii) the institutional design of the article 218 TFEU procedure (ex article 300 TEC) and (iii) the functioning of committees are all important structural elements which provide the necessary conditions for a cooperative contract to emerge; preference convergence constitutes in such a context rather the norm than the exception.

EU law and the duty of cooperation

The P-A studies in external relations rely heavily on the traditional competence-distribution law which is in line with P-A's discrete contract approach. However the clear demarcation of responsibilities via distributing competences is far from being equal with goal conflict. Case law in the EU has progressively created a cooperation jurisprudence referred as 'the duty of cooperation' by which Member States and EU institutions are encouraged to enhance their joint performance on the international scene (Hillion 2009). In particular the duty of cooperation based on Article 4(3)ⁱⁱ TEU (ex article 10 EC amended) has been established by the ECJ as a general principle to foster harmony between the Commission and the Council when acting jointly in multilateral treaty negotiations. The duty of cooperation is accompanied by enforceable procedural obligations (e.g. information and consultation) to "foster an attitude of mutual support, rather than an instinctive territoriality reflex" between the Council and the Commission (Hillion 2009). This duty of cooperation binds both Community and Member States for both types of agreements (i.e. exclusive and mixed) as well as for 'first' and 'second' pillar policies. The duty of cooperation together with the principle of loyalty are expressions of Community solidarity in the realm of external relations which according to the ECJ: "is the basis...of the whole of the Community system" (Hillion 2009).

The article 218 TFEU procedure

The article 218 TFEU procedure as a politically mandated coordination structure has been set up to negotiate and conclude international agreements. The Commission and the Council are subject to this procedure, which consists of consecutive and interrelated decision-making stages (i.e. authorization, negotiation, ratification) by which cooperation becomes imperative if there is to be any result achieved. The procedure results in that sense in a high degree of reciprocal interdependence between Council and Commission in which one institution's output is an input for the other's activities and in a sequential manner that institution's output becomes the input for the other institution at a later stage (Thompson 2003). The result is that none of the participating institutions (i.e. Commission and Council) can under the given mandated framework accomplish its relevant objectives without the other; tasks, operations and control functions become complementary and interrelated. Furthermore the institutional structure of the article 218 TFEU procedure has important implications on the information asymmetries between the Council and the

Commission. Tasks and operations become complementary and interrelated and lead to a dissemination of information, which prohibits the development of an information monopoly by the Commission. Agency descriptions of a highly knowledgeable technocratic Commission whose actions cannot be monitored by the Council due to a lack of information and technical know-how seem to be unjustified. Information sharing between Commission and Council officials takes part either implicitly via the numerous informal contacts and/or explicitly via the mutual disclosure of plans, programs, the use of formal communication channels, the liaison role of the Council committees as well as joint planning activities and joint supervision in the institutional set-ups of negotiated Treaties (e.g the Energy Community Treaty, the WTO Treaty etc.).

The Council working groups

Cooperation and the dissemination of information translates further to the main decision making centers, the Council working groups, important deliberative arenas in which national representatives and Commission officials bargain and argue in the search for common solutions. A number of scope conditions which have been identified to facilitate socialization processes and the development of trust relations are particularly well established in these lower technical policy arenas (Beyers 2005). The frequency and duration of interactions between Council working groups and Commission interlocutors favor developing predictable and long-lasting exchange relationships. The expectations of a long-term relationship and the accompanied effects of habitualization and socialization create in these working groups a 'collegial climate' in which expertise and the need to maintain a high level of problem solving capacities remain important aspects of the contract. In contrast to comitology committees, Council working groups do not vote formally and are expected to reach an agreement via consensus seeking practices. In such a context trust and a predisposition to cooperate become essential; rather than seeing commission officials as the antagonistic 'other' committees respect the latter as reliable interlocutors (Beyers 2005). In conclusion the increasing cooperative jurisprudence with regard to EU external agreements, the article 218 TFEU procedure and the work of the Council committees have an impact on the degree of shared interests between Council and Commission as well as on the degree of information availability. It is within such a context that one must critically re-examine P-A's reasoning of continuous preference divergences and information asymmetries between the Council and the Commission.

Re-interpreting the contractual safeguards in EU external relations

The assumptions of the P-A model have a direct impact on the contractual safeguards which are installed in the post-contract stage; contractual stability is here provided via exogenously imposed control mechanisms. The contractual relation is entirely formalized specifying responsibilities and obligations, which are enforced via sanctions in case of non-compliance. According to this logic the principal's task is to craft governance arrangements with minimal costs that ensure the delivery of the desired outcome. As exchange hazards rise so must contractual safeguards. Whereas contractual solidarity is entirely ignored by the P-A model, in relational contracting it constitutes the backbone of the contractual arrangement. Good faith and trust come before procedural regularity in the context of conflict resolution. Procedural regularity and the imposition of sanctions is a last resort within a process in which trust has declined below a certain threshold. Hence relational contracting deals with risk hazards via the functioning of social norms of solidarity and information sharing. Solidarity promotes a mutual approach to problem solving via mutual adjustment (Poppo and Zenger 2002). In that sense the legal mechanisms offered by specific contracts are not strictly followed but the parties themselves; social norms govern the exchanges within mutually acceptable trusting behaviours (Macaulay, 1963). Uzzi argues in that regard that the relational contracting implies a very powerful functional logic since the embeddedness of exchanges within social structures economizes on time otherwise spent in costly contract renegotiations. Gulati (1995:93) is also quite explicit arguing in favor of social norms in 'regulating' governance arrangements:

"trust avoids contracting costs, lowers the need for monitoring, and facilitates contractual adaptation. Trust counteracts fears of opportunistic behavior and as a result, is likely to limit the transaction costs associated with an exchange... In other words, trust can substitute for hierarchical contracts in many exchanges"

The two main contractual safeguards which have been analyzed by the P-A model, the negotiation mandate and the Council committees contain in that regard many elements from relational contracting and should not be interpreted solely on the basis of the P-A paradigm. The negotiating mandate due to its flexible format is not necessarily there to limit the discretionary authority of the Commission during negotiations as has been suggested by the P-A model. Power enabling imperatives come also into play by which the parties do not agree on detailed plans of action but on objectives and on general provisions that are broadly applicable. The specification of strict criteria on Commission behavior would be counterproductive in that sense (Milgrom and Roberts 1992:131). The negotiating mandate is therefore strictly speaking not a formal safeguard as has been suggested by the P-A model. Its function is not to constraint a priori the Commission but rather to ensure coordination and enable it to create joint value during negotiations with third parties. In addition the portrayal of Council committees as watchdogs serving the interests of the Member States vis-à-vis the Commission overlooks the fact that the committee has equally an interest in achieving

an EU wide consensus on particular policy problems. Hence the committee does not have necessarily a 'fixed' affiliation towards the Council. It serves rather as a kind of mediator between the political and technical levels assembling national experts around a policy field (Haas 1992).

Conclusion

This study aimed to challenge the 'correctness' of the assumptions of the P-A model in the realm of EU external relations. P-A assumes that the political practice in question is always based on preference divergence between the Council and the Commission, which manifest itself in goal conflict. However the results of the P-A model rest on largely untested factual assumptions; P-A offers an explanation claiming implicitly that the mechanisms of the explanation hold in the situation. It is by analyzing the idiosyncrasies of the institutional structure in the realm of EU external relations that one gets a rather different picture on Council-Commission interactions. Most studies have so far relied on the P-A contract perspective in which conflict between the Council and the Commission is taken for granted. However there are a number of indices, which allow to draw a different picture. EU case law, the institutional design of the article 218 TFEU procedure and the functioning of the Committee system are all important factors, which enhance cooperation and reduce inter-institutional conflict. In consequence preferences should not be treated as a constant but rather as a variable which can lead to non-conflictual relationships between the Council and the Commission. The contract becomes under such conditions 'relational' having important implications of how control mechanisms are ultimately exercised in the post-contract stages. Contract solidarity, trust and social norms become effective contractual safeguards, which are entirely ignored by P-A studies. This study offered a first exploratory attempt to shed light on the contractual arrangement between the Council and the Commission in EU external relations challenging wide held beliefs of unavoidable goal conflict and information asymmetries between these two actors. Further research will be needed in this area to enhance our understanding on what kind of contract is at work in Council-Commission interactions and how control mechanisms function within such an arrangement.

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Endnotes

ⁱ Police-patrol oversight refers to direct monitoring by the Principal aiming to detect any violations by the agent via the installment of formal control devices and the exercise of sanctions.

Fire-alarm oversight refers to oversight ‘from a distance’ by which the Principal relies on third parties (e.g. citizens, interest groups, other agents, courts) to monitor agent activity.

ⁱⁱ Article 4 (3) TEU: “Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks, which flow from the Treaties”

This principle applies also to CFSP Article 11(2) TEU which stipulates that : “ the member states shall support the Union’s external and security policy actively and unreservedly in a spirit of loyalty and mutual solidarity...They shall refrain from any action which is contrary to the interests of the Union or likely to impair its effectiveness as a cohesive force in international relations.”

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Ioannis Spyridakis is a PhD candidate at the Vrije Universiteit Brussel (VUB). His experience lies broadly in the area of EU external relations, ranging from matters of EU energy policy to socio-economic aspects of Trade liberalization. Ioannis holds Masters Degrees in International Business-Economics and in European Politics from the University of Rotterdam and the Free University of Brussels (VUB).