Preliminary

One Market, One Voice?
European Arrangements in International Economic Relations

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Abstract

This paper questions the optimality of EU arrangements in international economic relations. Depending on the issues under discussion, competence for external relations is devoted to a federal institution, to the member states, or be shared between both levels. As it seems, external representation is mainly the reflect of existing arrangements for internal decision-making. This cannot be optimal, since there is no reason why the mix of externalities and heterogeneity of preferences among member states should be the same for internal and external matters. Drawing on recent developments of incomplete contract theory, we therefore look more closely at the ex-ante and ex-post efficiency of three alternative schemes which provide a reasonably accurate representation of current arrangements: unconditional delegation, supervised delegation and coordination. We then apply this filter to an analysis of recent discussions in three fields: trade, financial stability, and macro-economic surveillance. We conclude by reviewing possible reforms in external representation.

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1. Introduction

Unlike unitary or even federal states, the European Union (EU) does not carry out international economic relations according to a single template. Depending on the field, competence for external relations belongs to the EU, to the member states, or is shared between both levels.

Clear examples of the first type are trade policy and exchange rate policy. Trade policy was made EU competence by the creation of the common market and it is fully delegated to the EU level. Not only are corresponding provisions common to all EU member states, but the authority to negotiate international agreements is permanently delegated to the European commission. Similarly, exchange rate policy was automatically made a EU competence by the creation of the euro and responsibility for it is shared between the ECOFIN Council (the gathering of EU finance ministers) and the European Central Bank.

At the other end of the spectrum, responsibility for financial assistance to third countries formally remains within the remit of the member states, which also participate individually in the governance of the Bretton Woods institutions and may take different positions on specific issues. Coordination has increased in recent years, but on a voluntary basis and without delegating representation to a European institution. When member states decide to adopt a common position in IMF board meeting, they may speak with one voice, but through several mouths.

In-between those polar cases lie a series of intermediate situations in which the member states adopt a common approach or take common positions without having delegated permanent negotiating authority to a EU institution. A significant example is the environment: it is the EU who negotiated the Kyoto protocol on global warming, whereas implementation is decentralized at the member state level. Similar situations can be found on issues of financial regulation.

Arrangements for participation in the G7/G8 finance ministers' meetings exemplify the complexity of competence assignment in the field of international economic relations. Ministers representing the four big EU member states participate in all discussions, alongside the minister of the country holding the presidency. The set-up is even more complex when the latter does not belong to the Eurozone: then EU and Eurogroup presidency do not coincide, and the president of the Eurogroup participates in discussions on macroeconomic surveillance. Similarly, the European Central Bank (ECB) is present for discussions on surveillance only, leaving room to national central banks when financial topics are addressed. Finally, the European commissioner for economic and financial affairs takes part as regards specific matters.

This complexity has repeatedly been criticized, either from inside or outside the EU. It is frequently claimed that it is bound to make the EU less able to play an active role in international discussion and to weaken its negotiating position. Numerous scholars (Alogoskoufis and Portes, 1990, Bergsten, 1997, Henning, 1997 Everts, 1999), civil servants (Direction du Trésor, 2002, Bini Smaghi, 2003) or politicians (Strauss-Kahn, 2002) have called for a further unification of the EU's external representation. The Commission itself has made several proposals to that aim, most recently on the occasion of the Convention (European Commission, 2002).

However, the draft constitutional treaty proposed by the Convention does not introduce significant changes in the economic and financial fields. While the creation of a EU "minister of foreign affairs" is a major innovation in the diplomatic field, as regards external representation in the economic and financial fields the draft treaty leaves the door open to future changes but does not depart significantly from previous treaty provisions[2].

Drawing on previous research on international discussions on the international financial architecture and on European governance (Coeuré and Pisani-Ferry, 2001, 2002), the questions we intend to investigate in this paper are why there is such complexity and whether the current arrangements are effectively inferior to the alternatives that are being considered.

The paper is structured as follows. We first take up in section 2 the description of existing arrangements. We move on to presenting their origin and economic rationality in section 3. Section 4 is devoted to assessing their ex-ante efficiency in the light of existing theories of political institutions and delegation structures. Section 5 builds on this analytical framework to discuss the contribution of Europe to recent discussions in three fields: trade, macroeconomic surveillance, and financial architecture. Conclusions and policy recommendations are drawn in section 6.

[2] Art. III-90 of the draft constitutional treaty states that "The Council of Ministers, on a proposal from the Commission, may adopt appropriate measures to ensure unified representation within the international financial institutions and conferences".

2. Europe's arrangements for external economic relations: an analytical survey

Reasons for differences in existing arrangements

There are several reasons why arrangements differ.

- The first reason has to do with *competence assignment* in intra-EU affairs. Competence for a given field may legally remain within the exclusive remit of the member states or be assigned, in full or in part, to the Union. In the latter case, it falls into one of the four categories defined in the draft EU constitution[3]: exclusive competences of the Union, shared competences, special coordination competences, or supporting competences (Art. I-11 to I-16). Competition policy, commercial policy and exchange rate policy belong to exclusive competences. Environmental policy and single-market related policies belong to shared competences. Macroeconomic policies belong to the third category, special coordination competences. Following a well-established jurisprudence, the draft constitution requires that exclusive internal competence automatically extends to external competence as Art. I-12-2 states that "The Union shall have exclusive competence for the conclusion of an international agreement when its conclusion is provided for in a legislative act of the Union, is necessary to enable it to exercise its internal competence, or affects an internal Union act".
- Second, the *legal basis for delegating negotiation authority* varies. Commercial policy is governed by Art. III-217 (formerly Art. 133) which determines how the Commission, which is in charge of negotiations, is held accountable to the Council of ministers. For exchange rate matters, Art. III-228 applies. It sets out how the Council may make decisions on exchange rate matters without jeopardising the independence of the central bank nor its mandate to maintain price stability. Finally, other international agreements are covered by Art. III-227. The procedures here resemble those covering trade policy, but without an exclusive role for the Commission: the Council has more discretion as regards the choice of a negotiator.
- Third, *voting rules* differ. The Convention has proposed to extend the scope of qualified majority, but unanimity has been kept in some fields such as cultural services.

[3] In this paper, we refer unless specified otherwise to the provisions of the draft constitution whenever we want to discuss the legal basis for Union acts and policies. This assumes that amendments in the inter-governmental conference will not alter the thrust of current provisions and that the constitution is going to be ratified.

- Fourth, *there is not a single agent* even in those fields where delegation is given to the Union, the latter can either be a federal institution (Commission, European Central Bank or specialised agency) or the presidency of the EU and the Eurogroup. Similarly, principals may or may not include the European parliament[4] (and appeal to the European Court of Justice may or may not be possible). In general, the set-up is thus one in which there are several principals and one agent.
- Fifth, *principal(s)/agent(s) relations* also differ a great deal as the degree of control exercised by member states varies from being legally prohibited (for monetary policy or competition policy) to very tight (for, say, international environmental or trade negotiations, which involve frequent consultations with member states in the midst of ministerial negotiations with third countries).

Thus, there is not a single template for delegation to the Union. To bring additional complexity, it should also be noted that the agent may change over time (in the case of the rotating EU or Eurogroup presidency) and that in some fields, the member states and the EU trade places: for example, finance ministers participating in G7 meetings can be regarded as agents of the Union in the fields where the ECOFIN has previously decided on a common position.

Three models

Table 1 provides a description of the state of play in eight sectors, according to four criteria: legal competence, governance model, voting rules and principal / agent relationship. The complexity and the variance of the arrangements is striking. Nevertheless, three basic models can be distinguished.

In the *first model*, competence to act is entirely assigned to a EU body according to, and within the limits of, a predefined mandate. This body then retains full discretion within the limit of its mandate and can only be made accountable on an ex-post basis. This applies to the Commission's competition policy decision (including when they have extraterritorial effect as recently illustrated by the GE-Honeywell case), subject only to appeal to the European Court of Justice (ECJ) and possibly to non-jurisdictional checks and balances such as the reaction of public opinion and/or protest or retaliation of non-EU countries.

[4] For a discussion of the role of the EP as a principal of the Commission in a political science perspective, see Pollack (2003, section 3).

A similar template applies to the exchange rate policy of the ECB: while, following the Maastricht Treaty, Article III-228-2 of the draft constitution envisages that the Council formulates “general orientations”, this provision has never been used and the European council has agreed in 1997 that it could only be used in exceptional circumstances, for example in the case of severe misalignments. Most observers and scholars regard it as ineffective[5]. The only effective constraint on the ECB actually derives not from internal EU rules, but from the procedures of the Group of Seven, which give a prominent role to the ministers’ deputies: an exchange rate intervention taking place within the framework of the G7 would thus require prior consultations with the president of the Economic and Financial Committee of the EU. But it can be argued that these procedures do not stem from legal but rather from practical considerations: given the importance of public signals in this particular field, the ECB would not take the risk to undertake market operations without prior consultation, then public backing of EU ministers.

The second model is one in which a EU body acts as an agent with the member states (and frequently the European parliament) playing the role of multiple principals. The standard case in this respect is trade policy: according to Art. III-217-3, after being given a mandate by the Council, “the Commission shall conduct negotiations in consultation with a special committee appointed by the Council of Ministers to assist the Commission”. The so-called Committee 133 (according the old treaty numbering) meets frequently to monitor the negotiation process and give guidance to the trade commissioner.

Mutatis mutandis, a broadly similar pattern applies in the fields of single market-related regulatory issues such as services and financial markets regulation, albeit with significant differences: ongoing discussions between internal market commissioner Fritz Bolkestein and the US authorities on the consequences of the Sarbanes-Oxley Act do not prevent some member states to discuss on their own. The same applies to environmental negotiations, with the difference that the Council presidency may play the role of the agent as member states are keen on retaining their responsibility instead of transferring it to the Commission. Also the negotiation mandate can have a more informal character, as for issues such as the regulation of auditors, for which ultimate responsibility rests with national regulators.

The *third model* is one in which member states do not delegate responsibilities or external representation roles to the EU but coordinate among themselves while retaining their roles in

[5] It was not even used in September 2000 when the ECB and other G7 monetary authorities intervened jointly on FX markets to support the euro.

various international fora. Examples can be found in the macroeconomic and financial fields[6]: the ECB, the Commission and the Council presidency play a minor and informal role in the various "G-x"s (G7, G10, G20) or in the Bretton Woods institutions (IMF and World Bank boards, International Monetary and Financial Committee of the IMF – IMFC). Interestingly, the ECB has been granted an observer seat at the IMF board while the Commission has not. Increasingly, however, member states aim at defining common positions on major topics of discussion. Since the European Council of Vienna (1998), prior discussions take place within the ECOFIN, the Economic and Financial Committee (EFC) and a special EFC sub-committee on IMF-related issues, which result in the adoption of common understandings[7]. In turn, those common understandings are expected to influence the positions taken by the member states in international discussions, but they do not have a binding character. In a way, thus, the member states, while being individually represented, are expected to behave as the agents of the Union.

We may call the first model *unconditional delegation*, the second *supervised delegation* and the third *coordination*. We can thus simplify Table 1 and replace it by Table 2.

Table 2: Models of delegation in EU external economic relations

Model	Main features	Examples
Unconditional delegation	Policy responsibility delegated to EU institution Monitoring by MS, if any, not binding on decisions by EU institution	Competition policy (subject to appeal to ECJ) ECB exchange rate policy (monitoring by Parliament)
Supervised delegation	External representation and negotiation authority delegated to EU institution MS exercise surveillance: issue guidelines and monitor implementation	Trade in goods and services Market regulation Environment
Coordination	No delegation of external representation to EU institution MS coordinate among themselves and with EU institutions, may or may not commit to follow guidelines	International macroeconomic and financial affairs (G7, Bretton Woods institutions)

This classification involves some simplifications. First, we overlook the important issue of unanimity vs. qualified majority, which cuts across our categories. Second, within a given

[6] And also in the field of financial services – the Commission does not participate in the Financial Stability Forum, although it has responsibility for bilateral discussions with the US on some of the FSF topics – as well as in the field of environmental discussions – the Commission is the agent for negotiations but specialized UN committees are attended by the member states.

[7] Bini Smaghi (2003) provides an informed and detailed account of those changes.

policy domain, one can observe a combination of models. A typical example is development assistance, where member states may operate through EU instruments (model 2), speak with one voice at multilateral development banks boards (model 3), or act on a bilateral basis through their national financing bodies. Third, the distinction between the three models may be blurred by the evolution of current practice. For example, in the macroeconomic and financial field, a pattern of informal delegation broadly similar to the one that exists in other fields has recently been adopted for discussions on issues related to the euro: in the IMF board, the country holding the presidency (or the chair that represents it) takes the floor on behalf of all euro area countries when such matters come on the agenda (Bini Smaghi 2003). Similarly, the president of the Eurogroup attends the surveillance part of the G7 meetings and the president of the ECOFIN speaks on behalf of the EU in meetings of the IMFC. However, individuals member states do not leave the room and they rarely refrain from taking the floor. As trade commissioner Pascal Lamy likes to say, they may speak with one voice (although not always), but not with one mouth.

Nevertheless, we think our three categories capture the gist of the governance of external economic relations as organised in the EU.

3. Where does the assignment of competence come from?

The first question to ask about the evidence presented in the previous question is what determines the degree of centralisation of competences for external economic policy. In a standard model of a federation, competence assignment results from a trade-off between, on the one hand, preference heterogeneity and, on the other hand, externalities and economies of scale (Oates, 1972, Alesina, Angeloni and Etro, 2003). On the basis of this positive approach, those two criteria should make sense of the observed variance in the degree of centralisation.

A rationale for centralisation could hardly be found in the similarity of preferences. European countries have a single trade policy event though they are known for having significantly different attitudes vis-à-vis trade liberalisation, for reasons that have to do with both intellectual tradition and sectoral specialisation. The same applies to competition policy, with varying degrees of tolerance to state aids, and unequal specialization in industries exhibiting substantial market power.

Similarly, exchange rate policy preferences may differ as a consequence of different levels of the real exchange rate, different degrees of openness vis-à-vis non-Eurozone economies, trade patterns, and market power. In financial matters, country preferences are also dissimilar, depending on financial exposure of the domestic banking system to international financial markets and specifically to emerging economies, and on the location of financial centres.

But economies of scale are very high, even overwhelming. The customs union and the single currency automatically imply a common trade policy and a common exchange rate policy. The same applies to market regulation: discussions with third countries on issues such as right of establishment, mutual recognition, harmonisation of standards, etc.. can only be dealt with at the level of the single market. This is also true for environmental regulations.

Apart from economies of scale, international negotiations *per se* involve strong externalities as the pooling of voices and votes gives the EU a significant leverage. Taken individually, all EU member states are relatively small players (and increasingly so), while the EU as a whole is evidently a major player in international negotiations.

Taking these criteria as a yardstick, it is apparent that functional logic predominantly determines current arrangements. Unconditional or supervised delegation essentially takes place where domestic arrangements make having a single external policy technically inevitable. Where this functional logic is absent, as for international financial issues, member states have generally retained autonomy. In other words, instead of being determined by the balance between costs and benefits, external unification appears to be a mere by-product of internal unification[8].

Another consequence is that competence assignment is determined by externalities and economies of scale on the domestic playfield rather than in the global economy. This can be illustrated by looking at two sets of issues, fiscal policy and development aid. EU members states have agreed to speak with one voice at the board of IMF when their individual fiscal position comes on the agenda. This is not because the French or German fiscal policy have an impact on the world economy, but only because Europeans think that member states fiscal policies imposes an externality on the single monetary policy –hence the need for formal coordination in international discussions, as it is the case within the Union. At the other end of the spectrum, member states do not feel compelled to harmonise their foreign aid policies because there is no externality at the EU level, even though coordinated allocation of EU financial assistance could make it significantly more effective for receiving countries.

[8] This applies even in fields where member states express strong preference heterogeneity. In those cases, unanimity provides a guarantee even though competence was transferred to the Union. This applies to some aspects of intellectual property and to cultural services, which France has insisted should remain outside the scope of qualified majority voting. See Art. III-217-4 of the draft constitution.

These observations help explaining why internal monetary unification has not led to the unification of European chairs on the IMF board. As developed by Bini Smaghi (2003), the functional argument for this unification is not a very strong one now that the focus of IMF activities has crept away from exchange rate surveillance and toward international financial stability and financial system integrity. For a unification of European seats to take place, there should be another motive.

This rationalisation raises questions as it seems to ignore the voting leverage argument. Especially, many observers have argued for long that a pooling of EU or euro-area votes within the IMF would enhance European influence to the point where it could rival that of the United States.

This quantitative side of the argument has been studied by Bénassy-Quéré and Bowles (2002) who provide simulations on the implications of various patterns of unification of the European representation in the executive board of the IMF. The determination of the voting rights that would be allocated to a single European seat (or a common seat for euro area member states) is not straightforward as IMF quotas are not strictly determined by a mathematical formula. What the simulations suggest is that the gain in influence arising from the merging of European seats would partially be offset by a reduction in the total weight of European votes. Even assuming all the representations of all the 15 present member states would merge, Europe would still appear to weight less than the US, albeit by a narrow margin (Table 3).

Table 3: Simulated quotas for a single European seat

As % of total IMF quotas	Present quota	Possible scenarios			
		Franco-German seat	Eurozone seat	EU 15 seat	EU 25 seat
France-Germany	11.2-12.2	9.8-10.8	-	-	-
Eurozone	23.5-28.2	22.1-27.0	12.9-16.1	-	-
EU15	30.3-36.6	29.2-35.6	20.9-26.0	15.6-19.8	-
EU25	32.3-38.6	31.3-37.6	23.2-28.3	18.1-22.3	15.9-20.0
USA	17.5-16.6	17.7-16.9	19.6-19.2	20.7-20.7	21.3-21.2
Japan	6.3-8.3	6.3-8.5	7.0-9.7	7.4-10.4	7.6-10.7
Developing and transition countries	38.6-31.9	39.2-32.5	44.2-37.5	47.3-40.9	-

Source: Bénassy-Quéré and Bowles (2002). The first figure is that of a situation where the difference between the actual and theoretical quota is kept constant. The second figure corresponds to the theoretical quota resulting from a strict application of the Fund's formulae.

Nevertheless, the quantitative argument ignores the shortcomings of present arrangement. As noted by Bini Smaghi (2003), European segmentation in the IMF creates incentives for member states to play differentiation games even when views are similar and to seek greater influence through temporary alliances with non-EU countries[9]. Furthermore, some European countries such as Spain are in minority within their own constituency, while other such as the Netherlands have to take into account the views of the non-European countries they represent. It is thus hard to escape the conclusion that the current institutional set-up undermines European effectiveness.

Summing up, the unified or tightly coordinated arrangements for external representation seem to result from internal unification rather than from a balance between, on the one hand, preference heterogeneity and, on the other hand, economies of scale and externalities taking into account international interactions. In particular, gains in external influence that could be derived from further unification do not seem to carry a significant weight. This cannot be optimal but while the Commission (2002) had made proposals for a unification of the external representation of the euro area, the draft constitutional treaty proposed by the Convention does not propose to modify current arrangements in any meaningful way. The question, then, is: are Europeans happy with a diminished influence, or, are there other reasons why they resist unification in the field of external relations? Answering this question requires a closer examination of the efficiency of the present arrangements.

4. How efficient are the present arrangements? Theory

The next set of question relates to the quality of delegation and coordination arrangements. The issue here is not whether decision in a given policy domain should be assigned to the member states or the EU, but whether arrangements for either delegation and control, or coordination, are conducive to efficiency, for a given degree of centralisation.

Albeit phrased in a slightly different way, this is a familiar topic in the theories of the firm, of corporate governance, and of the design of political organisations. Building on the insights of the incomplete contracts approach, those three strands of the literature basically explore similar issues. The theory of the firm (Hart and Moore, 1990) examines the choice between

[9] A similar pattern has for long been observed by scholars of the G7.

integration and subcontracting to an outside agent. The theory of corporate governance (Becht, Bolton and Roëll, 2002) discusses how to design an efficient set of contractual relations between an agent –the manager of the firm– and several principals –shareholders and possibly other stakeholders (employees, creditors, sub-contractors and the like). Recent research on constitutional design (Maskin and Tirole, 2001) aims at determining which decisions should be handled directly by the people, which should be left to elected politicians, and which should be assigned to independent agencies.

The problem of how best to organise relationships between the member states and a EU institution in charge of a given policy domain is intellectually of the same nature. That of organising coordination among member states and delegation to a subset of them is not essentially different.

More precisely, in analysing the efficiency of the EU external economic arrangements we can think of member states as multiple principals confronted with an organisational choice as they embark on a negotiation or a set of negotiations with third country partners. At time 1, they have to decide ex ante on a delegation or coordination mechanism. At time 2, after the negotiation has taken place, they assess the results and may decide on how to organize themselves for the rest of the negotiation. We can map our three models[10] as follows.

- Model 1 shall be called *unconditional delegation*. Decision for the negotiation is entirely and irrevocably delegated to an independent agent. The mandate sets out the obligations of the agent and the principal(s) cannot withdraw the delegation given to the agent or monitor the implementation of the mandate. They essentially relinquish all control rights, with the only exception that they may hold the agent accountable ex post if he or she has unambiguously deviated from the mandate;
- Model 2 is *supervised delegation*. The principal(s) delegate authority for the negotiation but retain residual control rights, i.e. the Council decides ex post whether or not to endorse the choices made in the negotiation. It can also to a variable extent monitor the implementation of the mandate and possibly withdraw delegation if dissatisfied with the behaviour of the agent;
- Model 3 is *coordination*. There is no delegation. Instead member states commit ex ante to defend the same views in the negotiation. Ex post, the principals can assess the results, but

[10] Maskin and Tirole (2001) discuss alternative institutional arrangements for democratic governance and define three basic set-ups: direct democracy, representative democracy and judicial power. These set-ups share some features with, respectively, models 3, 2 and 1.

since they have individually been part of the agreement, they cannot collectively renege on it.

In a democracy, Model 1 is only acceptable when a precisely defined and relatively narrow mandate can be given to the agent. Maskin and Tirole (2001) provide a simple model which helps discussing when unconditional delegation is likely to be welfare-enhancing in comparison to either direct democracy or representative democracy. Their conclusion is that there are two main arguments for such arrangements. The first is informational: unconditional delegation is desirable when (i) the electorate is unsure of its own preferences, (ii) acquiring decision-relevant information is costly, or (iii) feedback to the principal (i.e. ex post information on the appropriateness of the decision taken) is weak. The second argument is distributional: delegation to an independent agency is preferable when the majority can inflict large negative externalities on the minority, and a dictatorship of the majority is therefore to be avoided (this is classically the case in corporate finance, e.g. in the analysis of take-overs).

These models help clarify the issues at hand. The *information cost* argument is for example relevant for FX intervention: daily monitoring of the foreign exchange market is better performed by a group of highly qualified technicians, which can be located in a central bank. Ex-post assessment of their handling of interventions would anyhow be very difficult to undertake by the general public. This compares, for example, to pension reform, whose results can be directly observed. The *distributional* argument is obviously relevant for competition policy, since the role of competition commissioner Mario Monti is to protect competitors and consumers. A degree of neutrality is required for decisions on individual cases, which cannot be taken for granted if those decisions are made by majority voting.

Thus there are situations where Model 1 is superior to Model 2. But Model 1 is only workable for narrowly defined policies[11]. Furthermore, the case for Model 2 becomes stronger when the electorate is able to evaluate the agent and the consequences of her decisions. The advantage of supervised delegation is that the agent is given discretion for implementing the mandate she has received but is held accountable ex post on the basis of an assessment of her behaviour. This is very much the rationale behind the approach adopted for international trade negotiation.

As an ongoing process where each participant defends its own interest, Model 3 (coordination) can in some sense be likened to direct democracy. This is the case for example if member states consult among themselves and vote prior to taking a position in international fora.

In the Maskin-Tirole set-up, the advantage of representative democracy over direct democracy is that it provides to elected officials an incentive to invest in the acquisition of information and to take socially optimal decisions event if this means confronting short-term popular beliefs. This is because elected officials have a longer-term horizon and may hope that the public will be able to learn about the appropriate decisions – and to observe the results of the decisions taken – before they are confronted to re-election. Here again, those results can be transposed to our case. Negotiations which involve short-term losses and long-term gains may best be conducted through an agent that is able to internalise trade-offs and to propose a package for ratification, thereby also avoiding the tyranny of the minority – "pork-barrel" pandering. This is the case for trade and for environmental issues, where powerful special interests (e.g. respectively, farmers or the heavy industry) are at stake. Hence, the virtues of Model 2 (supervised delegation) over Model 3 (coordination).

Coordination, however, should be preferred when information acquisition is not excessively costly, the risk to minorities is small, or when the agents (i.e. EU institutions) tend to be biased towards private agendas or interest groups – which boils down to a judgement on the quality of the European constitution. But there is another argument against it: committees where members are elected and are individually accountable for the positions they have taken encourage pandering because each participant faces a strong incentive to cajole popular beliefs even if he knows that they do not correspond to the socially optimal choice. The motive for this behaviour is that the decision involves a kind of prisoner's dilemma: making the right choice only involves costs if the other members of the committee do otherwise.

Summing up, the insights from the contract theory approach suggest that there are few strong arguments in favour of the coordination mode. Obviously, this ignores other constraints such as the fact that the external aspects of policies is frequently not separable from their domestic component (for example, G7 meetings involve coordination among individual member states when the policies that are being discussed are within their remit). But for those policies which do not have this dual character, it is hard to find compelling arguments in favour of coordination.

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[11] Maskin and Tirole (2001) show that the optimal degree of discretion is lower for judicial power than for representative democracy.

5. How efficient are the present arrangements? Appraisal

The assessment in the previous section has been based ex-ante on the insights provided by the theory. It must be complemented by an ex-post appraisal. Here, we shall focus on three major fields: trade, macroeconomic surveillance, and international finance. Before that, we must introduce additional criteria for assessing performance.

Risks

The approach taken in the last section basically uses the expected quality of individual decisions as a criterion for assessing modes of delegation. From a more practical standpoint, some other criteria must be introduced. We consider three risks have to be assessed: inertia, internal inconsistency and inconsistency with other players.

By *inertia*, we mean an hysteresis of decisions due to the difficulty to depart from past internal compromises. This risks exist whenever internal negotiations result in formalising an agreement that ends up reflecting a particular state of nature. It is present in all three models (including coordination when common understandings are elaborated), but its consequences are more severe when compromises end up being enshrined in a treaty. A response to this risk is to introduce in Model 2 the possibility of recontracting, i.e. to redefine periodically the mandate given to the Commission or the Council. However, this possibility involves a downside: the recontracting reduces the ability of the agent to commit in discussions with partners. In a recent paper, Aghion, Dewatripont and Rey (2003) introduce the notion of transferable control, i.e. a situation where the principal cannot commit not to transfer control away from the chosen agent. When control is transferable but not contractible, it can be preferable to transfer control unconditionally and learn instead from the way in which the agent exercises it.

The second risk is *mutual inconsistency* between different external policies. When the reasoning outlined above is applied in isolation to each policy domain, there is a risk to overlook the externalities arising between them. For example, any rescue package decided by the IMF implies simultaneously short-term monetary financing to avoid a liquidity crisis, longer term financial assistance, and debt restructuring. In the EU, these functions are organised under different schemes, which may result in conflicts of interest among member states and EU institutions. At some point, there may be a contradiction with the need to focus the mission of the agent.

The third risk is *inconsistency between the EU representation mode and that of other major players*. The US have a centralised mechanism with full delegation to the administration or the USTR, but residual control is exercised by the Congress under procedures which differ depending on the issue into consideration. Some other actors are not big enough to weight on the international stage and they have to group together, raising delegation issues of their own within their group (the G22 being an example in the trade field). When the EU model differs from its counterpart, this can generate additional transaction costs and/or delays.

We now turn to our three test cases.

Trade

The virtues of the model adopted for trade negotiations have been emphasised in the previous section. By combining delegation with supervision, the set-up seems to take the best of both worlds and it is generally regarded as a major factor behind the fact that the role the EU plays in international trade negotiations significantly exceed its role on other major international topics. This is apparently also the opinion of Pascal Lamy (2002), who regards the trade delegation regime as a model for EU external relations.

This however ignores the role played by the so-called Committee 133 which "assists" the Commission in the negotiations and meets almost permanently on the margin of the discussions between delegates. In practice, this committee permanently assesses changes in the dynamics of the negotiation and gives guidance to the Commissioner as regards the appropriate strategy or the concessions he is allowed to make.

This is very different from the US Trade Promotion Authority (TPA) procedure. Like in Europe, the US Trade Representative (USTR) is given by Congress a mandate to negotiate and must report to Congress on the result of the negotiation. But unlike in Europe, the USTR has a relatively free hand within its mandate and when it reports to Congress after negotiations have been completed, the legislator can only ratify or reject the bill, not amend it. As a result, the USTR has substantially more leeway in the negotiation process than his European counterpart.

In contrast, Committee 133 and the Council are involved in the kind of *permanent recontracting* outlined above, and this is also the case for negotiations led by the Council presidency over environment protection. This relationship has the defect of blurring the distinction between the role of the principals and that of the agent, as would be the case in a company whose board of directors would embark into micromanagement. We doubt this method is an asset for the EU in the international negotiations.

Macroeconomic surveillance

One has to distinguish between surveillance of fiscal and structural policies, which is entirely governed by coordination, and exchange rate surveillance, where the EU has a single representation. As already noted, member states have committed to speak with one voice at the IMF and G7 on the former issues, where externalities are not well established. Conversely, and somewhat paradoxically, it has often been noted that they have expressed different opinions on the exchange rate, where they should speak with a single voice, and that this has been confusing at times both for Europe's main partners (the US Treasury and Japanese MoF) and for market participants.

This leads to two conclusions. First, the devil is in the details and the unconditional delegation structure ("Model 1"), however attractive from a theoretical standpoint, can be undermined by a poor implementation (i.e. if no constraint exist that prevent principals from speaking with many voices). Second, paying lip service to coordination ("Model 3") may not be useful when member states have genuinely diverging interests.

International finance

In a previous paper (Coeuré and Pisani-Ferry, 2001), we compared the EU and US reactions to the financial crises of the late 1990s and their contributions to the so-called "international financial architecture". Building on four test cases (IMF mandate and instruments, private sector involvement in crisis resolution, capital flows and exchange rate regimes, and IMF governance), we concluded that the US behaved as a benevolent hegemon of international finance, and that Europe's contribution was not up to its own vision as a world monetary and financial power.

How does this fit into our analytical framework? International finance is a field where Model 3 (coordination) mostly applies. Do the criteria favouring coordination apply? This is less than clear, since financial issues have a high technical content and may confront special interests (e.g. in the case of debt restructuring involving a haircut for creditors, and therefore for their shareholders). To some extent, the importance of G7 European members (France, Germany, Italy and the UK) in a discussion where the G7 played a leading role can be likened to a delegation structure as in Model 2. The scope of the mandate was however unclear, and transaction costs generated significant inertia (it took several months until a EU position paper on international architecture could be written, and once written, it could hardly evolve in real time).

6. Conclusions

Deficiencies in the external economic and financial representation of the EU have for long been noted and criticised by advocates of further European integration. Yet the advent of the euro has failed to trigger the overhaul in existing arrangements they expected. While not negligible, the changes introduced in the 1990s and those considered for the 2000s are of an incremental nature:

- the Eurosystem has taken over the international monetary and exchange rate responsibilities of the national central banks, but not their financial responsibilities;
- the president of the ECB has replaced national central bank governors for the surveillance part of the G7 ministerial meetings but not for the discussion on other topics, and while the president of the Eurogroup has been given access to those meetings, ministers still play a prominent role and preparation is still carried out by their deputies;
- coordination among Europeans on international financial topics has been enhanced and the ECB has been granted an observer status in the IMF board of directors, but member states retain their individual membership in the Fund;
- in the trade field, the draft constitution envisages limited changes in the list of topics that are subject to qualified majority voting;
- finally, no major change has been introduced on issues such as development assistance.

Those changes fall short of the grand transformations envisaged by observers since the early 1990s, such as the replacement of national central banks by the ECB in all international fora[12] (Bergsten, 1997, Everts, 1999), the appointment of a single euro-area representative to G7 meetings and their subsequent transformation into G3 meetings (Alogoskoufis and Portes, 1991, Henning, 1997), the reorganisation of euro-areas constituencies in the IMF (Alogoskoufis and Portes, 1991) or their merging into a single constituency (Everts, 1999).

The reason why those transformations have not taken place is that while they could have been desirable, they were not an automatic consequence of the single currency. As developed in

[1212] Bergsten (1997) writes « it seems axiomatic that the ECB will replace the individual European central banks in all forums where the latter are now represented".

this paper, changes in the external representation of the EU have so far been limited to the almost mechanical consequences of the creation of the euro.

From a positive standpoint, this paper has argued that European choices in this field do not seem to derive from an attempt to maximise welfare. From a normative standpoint, it has observed that the current arrangements involve significant deficiencies that weaken the European position in international negotiations and thus involve welfare costs.

What are the prospects for change? Lessons from recent history and the timidity of the constitutional changes under consideration both suggest caution. However, there are two reasons why 'business as usual' cannot be taken for granted. The first is the rapid rise of the economic and political weight of emerging countries. The failure of the Cancun trade talks in 2003 will certainly trigger new thinking on the WTO negotiation structures and more generally the representation of emerging countries in international economic fora. This is bound to increase pressure for a streamlining in European representation in informal and formal gatherings. The second reason is the envisaged creation of a EU 'minister of foreign affairs'. If successful, this model which merges Commission and Council responsibilities is likely to spill over onto other fields. Actually, it has already been suggested to apply the same model to the ECOFIN. If this were to happen, it would end the rivalry for international representation between the Commission and the Council and facilitate the emergence of a more assertive EU.

While those issues are still far from being on the policy agenda, we thus consider important to put forward and discuss proposals for reforms in the external representation field. On the basis of the analysis carried out in this paper, our wish list is as follows:

1. The scope for an extension of the unconditional delegation model is limited. On the basis of our criteria, the only field in which there is a prospect for delegating representation to an independent agency is the regulation of securities markets. If created, a European Security and Exchanges Commission should be given the responsibility for relations with corresponding agencies in third countries. This would be preferable to leaving it within the remit of the member states themselves (coordination) or to giving responsibility for it to the Commission and the EU Council (delegation). In addition, if a competition policy agency is created as suggested by the recent Sapir report (2003), it should be responsible for the extraterritorial implications of it (but this would only mean transferring responsibility from the Commission to this agency);

2. There is a case for clarifying the scope and the methods of supervised delegation by adopting a single template for it. The present situation, where similar but not identical models coexist, is excessively complex. Instead, the Commission, not the Presidency, could be given responsibility for representing the EU in all international negotiations on regulatory issues pertaining to the operation of the single market. This should encompass financial services as well as environmental issues with a continental dimension. Furthermore, the template for such negotiations should be simplified and unified and the respective roles of the principal(s) and the agent defined better. As a rule, time-limited mandates should be adopted and the role of committees (which will anyway be less and less efficient as the number of participant increases with enlargement) narrowed down. Member states should keep their control rights in full but accept to exercise them on an ex-post basis rather than by exercising pressure on the agent throughout the negotiation process. Besides, the Commission should be represented alongside member states in international fora (Financial Stability Forum, UN environmental committees) where regulatory issues are discussed;

3. Coordination remains an appropriate model for issues which involve discretionary policy decisions and reliance on a variety of instruments, including those for which member states are responsible. This is the case for example for macroeconomic and exchange rate issues but also for structural reforms, ageing, etc.. Thus, we do not see a case for delegating representation in the G-Xs to the Union. However, this does not mean some simplification is not appropriate. The current system where Europeans enter and exit the room depending on the issue that is being addressed but are always far more numerous than justified by their economic weight is not workable.

4. The issue of IMF representation is a complex one as the Fund covers a wide array of policy domains, some of which justify delegation more than other. Furthermore, redesigning the constituencies is bound to raise significant political difficulties. We nevertheless consider that the arguments against the dispersion of the European 'voice' are strong ones and that a merger of European chairs would enhance the ability of Europe to play its international role in full.

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Table 1: A selective overview of the models of governance in EU external economic relations

	Legal competence	Governance model	Voting rules for MS	Principal / agent relationship		
				Principal(s)	Agent(s)	Type/degree of control
1) Micro						
Competition	EU exclusive	Delegation	MS do not vote	MS and EP	Commission	No control on Commission Appeal to ECJ possible
Trade	EU exclusive (for goods) Shared (for services)	Delegation	QMV (for goods) Unanimity for cult. services and intellect. property	MS and EP	Commission	Negotiation mandate Day-to-day control through Committee 133
Regulation of products and capital markets	Shared	Delegation (when applicable)	Mostly QMV	MS and EP	Commission	Negotiation mandate Ad-hoc committees
Financial services	Shared	Delegation (but frequently informal) Coordination in FSF	QMV	MS and EP	Commission MS in FSF	Informal negotiation mandate Ad-hoc committees
Environment	Shared	Delegation for negotiations Coordination in UN	QMV	MS and EP	Commission or Presidency MS in UN fora	Negotiation mandate Ad-hoc committees
2) Macro						
Euro exchange rate	EU exclusive	Delegation (for ECB) Commitment (for MOFs)	No vote on ECB decisions In practice, consensus	MS	ECB Presidency of Eurogroup	Weak Council control on ECB exchange rate policy Tight control on presidency
G7 coordination	Special competence for coordination	Coordination	Consensus	Council	ECB MS belonging to G7 Minor role for presidency	No control on ECB Tight control on presidency Loose control on MS
International finance	MS	Coordination	Consensus	Council	MS	Tight control on presidency Loose control on MS