Department of Public Policy and Management

RÉSUMÉ OF THE PHD THESIS

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Contributions to the Economics of Federalism – with Applications to European Integration

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1. Introduction and Motivation

The economics of federalism deals with issues related to multi-level governance within nation-states as well as in supranational structures such as the European Union (Musgrave 1965; Oates 1972; Inman – Rubinfeld 1999). Indeed, the process of European integration has become the subject of increased attention among scholars of federalism (Walsh 1993; Wildasin 2008). The dissertation seeks to contribute to both the economic theory of federalism and its application to the European Union.

Our approach is 'institutional' in the sense that we focus on the 'rules of the game' that provide the context of individual decision-making (North 1990). Following the approach of public choice, politics is perceived as a set of (multilateral) exchange relationships (Buchanan 1992). The formal logic of modern representative democracy implies that these relationships can be understood in principal-agent terms (Moe 1984). An important advantage of principal-agent theory is that it provides a unified framework for analysing national and supranational political phenomena. First, competition and co-operation among countries is a factor that affects agency relations within individual nation states. Second, supranational organisations can be perceived as agents of national governments as their principals (Tallberg 2003).

We focus on three subtopics. The second chapter abstracts from the details of principal-agent relationships within Member States and, as a starting point, assumes that citizens can employ two fundamental methods to influence national politics: "exit", i.e. emigration, and "voice", i.e. influencing public decision-making from within a country (Hirschman 1970). We argue that European integration changes the nature of the relationship between a citizen and his country, and, as a consequence, citizens will modify their exit and voice strategies. The third chapter examines how the agency relationship between Hungarian voters and national political representatives developed along the path to EU-accession. The fourth chapter deals with the consequences of EU-entry on agency relations within the Hungarian (and East Central European) national administration.

The selection of the specific topics was primarily motivated by the objective of theoretical innovation. The second chapter links the notion of 'specific investment' introduced into transaction costs economics by Williamson (1979) with Hirschman's exit–voice–loyalty framework. The third chapter introduces a novel model of political collusion, which links the spatial modelling of party competition with the problem of agency. The fourth chapter employs the concept of ‘tribalism’ (which is in turn based on Sen’s paradox) in a new context: public administration.

The other aim of the dissertation was to draw attention to processes that we think are of fundamental importance for Hungary as well as other Member States of the European Union. The second chapter identifies the complex but identifiable ways in which European integration influences the exit and voice decisions and the national loyalty of citizens. The thesis of the third chapter is that the pre-accession period in Hungary was characterised by a collusion among parliamentary parties. The main argument of the fourth chapter is that a ‘eurocracy’ has in many ways isolated itself within the central administration of East Central European Member States. This resulted in inner divisions and unexpected problems of co-ordination and efficiency.

2. Research Antecedents

The second chapter is basically an augmentation of Hirschman's exit–voice–loyalty theory. It tries to confront the insight of transaction cost economics (Williamson 1979) that specific investments are key to understanding the workings of long-term relationships with Hirschman's emphasis on loyalty as an equilibrator between exit and voice. The interpretation of loyalty relies on a rather wide range of authors: from economics (e.g. Axelrod 1984, Vanberg –Congleton 1992) to social psychology (e.g. Van Vugt – Hart 2004) to moral philosophy (e.g. Comte-Sponville 1998, Ewin 1992, Oldenquist 1982). The formal model purports to be original.

The third chapter draws on previous empirical research by political scientists on the Hungarian political system (see, in particular Bozóki – Karácsony 2004, Karácsony 2004, Fölsz – Tóka 2004, Kopecky – Mudde 2002). As for theory, it is based on a number of related approaches. The general incentive environment of Hungarian political representatives in the process of EU-accession is mainly explained by the findings of public choice on inter-governmental competition and multi-level governance (see, for example, Vanberg 2001, Salmon 1987, Kerber – Budzinsky 2004). The spatial model of political competition is in the tradition of Downs (1957), as augmented by Wittman (1973).

The fourth chapter perceives the European Union as a set of principal–supervisor–agent relationships. This approach has been developed, among others, by Doleys (2000), Tallberg (2003) and Blom-Hansen (2005). The effect of the European superstructure on Member State administration is taken to be analogous to the consequences of authority delegation within large hierarchical organisations (e.g. multidivisional firms). In both cases, a 'tribal conflict' can be expected to emerge. The analysis of tribalism is based on Miller (2002), who draws on Neuhauser (1988) and Sen (1970). Some former empirical results [see, in particular, Drulák et al. (2003)] fit well into our analytical framework.

3. Methods Used

The first chapter provides an overview of the first and second generations of the economics of federalism. Chapters 2–4 reflect the research methods used by the author.

The second chapter begins with an 'exegesis' of Hirschman's seminal writings on exit, voice and loyalty. As a next step, the concept of 'specific investment' is introduced. It is shown that it can be fitted into Hirschman's framework in two principal ways. It can either replace loyalty as an equilibrator of exit and voice; or help us understand under what conditions loyalty is likely to emerge. A formal model is developed to illustrate how changes in the degree of investment specificity can influence exit and voice – both directly and indirectly through loyalty. In the concluding section, European integration is interpreted as a process that reduces the country-specificity of various forms of personal investments by citizens.

In the third chapter, the theoretical method used is the combination of game theory and a spatial model of competition. A model of party competition versus collusion is constructed, and the conditions of a collusive equilibrium are enumerated. The model is then applied to solve a puzzle suggested by existing empirical work and commonsense observations about the Hungarian political system. A secondary analysis of existing empirical results is carried out. It is shown that the incentive structure of Hungarian parties with regard to the country's EU-accession was in many respects identical to the collusive conditions identified by the model.

The fourth chapter turns to empirical observations about the formal and informal governance structure of both the European Commission and national eurocracies to substantiate the claim that the behaviour of the latter can be interpreted as a special form of 'tribalism'. First. we attempt to outline the general incentive structure faced by public officials in Member States. We then show that the subjective perceptions of public officials are in harmony with what can be expected (according to the theory employed) as a result of the incentive structure previously identified. Finally, an illustrative example shows the relevance of our general findings to actual conflicts within the central public administration.

4. Main Results

Chapters 2 to 4 of the thesis contain the results of the author's research. The main results of Chapter 2 are outlined below in their entirety. Since the argument in the third chapter is fundamentally identical with that in Mike (2007), we do not repeat its main results here. Although, the core of the fourth chapter can be found in Mike (2004), the consequences of tribal behaviour on the functioning of the European Union and the European Commission, in particular, are not spelt out there. Therefore, we summarise them below.

Chapter 2

In the third chapter, we seek to explain how European integration influences citizens' exit and voice choices concerning their own country. Hirschman's theory needs to be augmented in order to answer this question. The main difficulty to be surmounted is that Hirschman considered loyalty as something given and failed to explain under what circumstances and to what degree it is likely to emerge. We offer two theoretical solutions for this omission. Both are based on the concept of specific (or idiosyncratic) investment, as developed by Williamson (1979). Our first thesis is that specific investments have the same effect on exit and voice as loyalty. As Gehlbach (2006) makes it clear, loyalty serves as an 'exit tax', which reduces the probability of exit and, at the same time, makes voice more worthwhile. Moreover, loyalty often has an 'active' component, which reduces the subjective costs of voice and therefore increases its intensity. An investment is called specific if it looses part of its value outside a given relationship. Specific investment therefore makes the loss from exit larger and the likelihood of exit smaller. Certain specific investments enhance the value of a relationship by reducing the costs of voice mechanisms. Such *voice-related investments* will lead to the strengthening of voice in a similar fashion as active loyalty.

Our second thesis is that some instances of specific investment are prerequisites for the emergence of loyalty. We identify five elements of the phenomenon of loyalty, which entail five types of rational decisions: emotions, trust, morality, the stability of preferences, and identity. We conduct the phenomenological analysis in order to specify the relationship between the rational decisions that underlie loyalty and specific investments. We emphasise that specific knowledge and co-operational know-how are the two most fundamental forms of specific investment. This suggests how the components of loyalty and investments can be linked. First, self-identification with a social group assumes that one has *knowledge* of this group. Which moral responsibilities one takes upon oneself is influenced by the fact whom one can actually help most. This, in turn, depends on whom one *knows* best, and helping whom one has *experience* about. As for the stability (rather than volatility) of preferences, the evaluation of alternative choices is based on *gathering and digesting information*, which can also be interpreted as specific investments. When a new alternative appears, the replacement of an existing relationship with the new one requires additional information. This investment requirement increases the relative value of the existing relationship. Trust is usually based on *prior acquaintance* and *co-operational experience*. However, the theory of repeated games shows that trust may be rational even in the absence of these pre-conditions, provided that the relationship has a high probability of survival. This probability is itself affected by the existence of specific investments, which induce the parties to keep their relationship going. As regards emotions, everyone must, to some extent, face the choice of 'specialising' one's emotions on one type of relationship or another as well as on one person or another. For example, the emotional aspect of a friendship can be perceived as a specific investment of our emotional capital, which brings a higher (emotional) value in one relationship than in others.

We can thus conclude that specific investments are, in many ways, preconditions of loyalty. This theoretical conclusion is corroborated by the empirical observation that loyalty is normally associated with relationships that are characterised by a high degree of specific investment (hierarchical organisations, family and other closely-knit personal relations, and the political community). Such real-life examples also make it clear that the presence of specific investments is not a sufficient condition for the emergence of loyalty. It seems more appropriate to say that certain forms of *specific investment create an environment that is conducive to the development of loyalty*.

The relationship between loyalty and specific investments is a complicated one. We must note that specific investment requires 'contractual guarantees'. The belief in the loyalty of the other party may serve as such a (partial) guarantee. However, there are a number of other forms of guarantee (such as third-party enforcement or market reputation). Thus, loyalty is not a *prerequisite* of specific investment.

We develop a formal model to illustrate the effects of changes in the specificity of investment on exit, voice and loyalty. We assume that the external utility of an investment increases for exogenous reasons. The model thus serves to show how *changes in the social* *environment* modify the incentives of exit and voice as well as influence the strength of loyalty.

Assumptions of the model. In a relationship, an individual can make two types of specific investment: one voice-related, the other not. In the short run, he cannot make any changes in his investments. In the long run, he can optimally adjust them to the new degree of specificity. The model's purpose is to investigate changes in the probability of exit, the level of voice and the strength of loyalty. The concept of loyalty is not made operational. It is simply assumed that a larger amount of specific investment increases the likelihood of (stronger) loyalty.

Short run. Assume that (i) the levels of voice-related (*I*) and non-voice-related (*Y*) investments are given; (ii) the investor then finds out the relative employability of these investment in the existing relationship (($s_m \in [0,1]$ and $t_m \in [0,1]$, respectively), and the best alternative relationship ($s_a \in [0,1]$ and $t_a \in [0,1]$, respectively) (iii) he decides whether to exit or stay in the existing relationship; (iv) finally, he chooses the level of voice in the relationship of his choice. When the individual decides about exiting, he considers the expected benefit from his investment and his welfare irrespective of his investment choice. The latter is assumed to be a probabilistic variable whose value becomes a certainty before the exit-or-stay decision.

We solve the individual's problem backwards. The optimal level of voice (*x*) in any relationship is given by the following equation:

$$(1) \qquad \max_x NB = B(x, s_j I) - C(x)\,,\; j = m, a\,,$$

where *NB* is the net benefit of voice, *B* is the gross benefit, and *C* is its cost. We assume that $C_x > 0$, $C_{xx} > 0$; $B_I > 0$, $B_{II} < 0$; $B_x > 0$, $B_{xx} < 0$; and $B_{xI} > 0$. The last inequality implies that $x^*_{\underline{s}} < x^*_{\bar{s}}$ if $\bar{s} > \underline{s}$.

Equation (1) gives the optimal value of *x* as a function of *I* and s_j ($j = m, a$). The net benefit can be interpreted as the maximum return of the investment under s_j:

$$(2) \qquad R(s_j I) = NB(x^*, s_j I)\,.$$

If the probabilistic welfare variable is η for the existing relationship, and ζ for the alternative relationship; and $W(t_j Y)$ denotes the return to the non-voice-related investment, the individual faces the following alternatives at the time of the exit choice:

(3) welfare in the existing relationship: $W(t_m Y) + R(s_m I) + \eta$

(4) welfare in the alternative relationship: $W(t_a Y) + R(s_a I) + \zeta$

The probability of exit (before the values of η and ζ become certain) is:

(5) $$\Pr[W(t_m Y) + R(s_m I) + \eta < W(t_a Y) + R(s_a I) + \zeta] =$$

$$= \Pr[W(t_m Y) - W(t_a Y) + R(s_m I) - R(s_a I) < \zeta - \eta].$$

Long run. In the short run, *I* and *Y* are fixed. In the long run, however, changes in s_a and t_a induce a re-adjustment of the investment levels. The optima of *I* and *Y* are given by the following equations:

(6) $$\max_{I,Y} (1 - \Pr_k)[W(Y) + R(I) + \eta] + \Pr_k [W(tY) + R(sI) + \zeta] - I$$

The first-order conditions are:

(7)

$$FOC^I = (1 - \Pr_k) R'(I) + \Pr_k \, sR'(sI) + \frac{\partial \Pr_k}{\partial I}[W(tY) - W(Y) + R(sI) - R(I) + E(\zeta) - E(\eta)] = 1$$

(8)

$$FOC^Y = (1 - \Pr_k) W'(Y) + \Pr_k \, tW'(tY) + \frac{\partial \Pr_k}{\partial Y}[W(tY) - W(Y) + R(sI) - R(I) + E(\zeta) - E(\eta)] = 1$$

The following three tables summarise our findings on the level of voice, the probability of exit and the strength of loyalty, respectively.

Table 1. Changes in the level of voice

Change in specificity	Type of adjustment		
	No adjustment (fixed investments; short run)	Adjustment of the investment affected in the first place	Adjustment of both types of investment (secondary effect)
Non-voice-related investment becomes less specific	0	0	Increase if the primary effect on the probability of exit is positive.*
			Decrease if the primary effect on the probability of exit is positive.*
Voice-related investment becomes less specific	0	Increase (normal case)	Increase unless $\frac{\partial Y^*}{\partial s} < 0$ is small.
		Decrease if the probability of exit rises extremely.	Decrease unless $\frac{\partial Y^*}{\partial s} > 0$ is large.

* See the middle column of Table 2.

Table 2. Changes in the probability of exit

<table>
<tr><td>Change in specificity</td><td colspan="3">Type of adjustment</td></tr>
<tr><td></td><td>No adjustment (fixed investments; short run)</td><td>Adjustment of the investment affected in the first place</td><td>No adjustment (fixed investments; short run)</td></tr>
<tr><td rowspan="2">Non-voice-related investment becomes less specific</td><td rowspan="4">Increase</td><td>Increase if $\frac{\partial Y^*}{\partial t} < 0$; or $\frac{\partial Y^*}{\partial t} > 0$ is small.</td><td rowspan="4">The primary effect is reinforced.</td></tr>
<tr><td>Decrease if $\frac{\partial Y^*}{\partial t} > 0$ is large.</td></tr>
<tr><td rowspan="2">Voice-related investment becomes less specific</td><td>Increase if $\frac{\partial I^*}{\partial s} < 0$, or $\frac{\partial I^*}{\partial s} > 0$ is small.</td></tr>
<tr><td>Decrease if $\frac{\partial I^*}{\partial s} > 0$ is large.</td></tr>
</table>

Table 3. Changes in the strength of loyalty

Change in specificity	Type of adjustment		
	No adjustment (fixed investments; short run)	Adjustment of the investment affected in the first place	No adjustment (fixed investments; short run)
Non-voice-related investment becomes less specific	Decrease	Decrease if $\frac{\partial Y^*}{\partial t} < 0$, or $\frac{\partial Y^*}{\partial t} > 0$ is small.	Decrease unless $\frac{\partial I^*}{\partial t} >> 0$.
		Increase if $\frac{\partial Y^*}{\partial t} > 0$ is large.	Increase unless $\frac{\partial I^*}{\partial t} << 0$.
Voice-related investment becomes less specific		Decrease if $\frac{\partial I^*}{\partial s} < 0$, or $\frac{\partial I^*}{\partial s} > 0$ is small.	Decrease unless $\frac{\partial Y^*}{\partial s} >> 0$.
		Increase if $\frac{\partial I^*}{\partial s} > 0$ is large.	Increase unless $\frac{\partial Y^*}{\partial s} << 0$.

By including the concept of specific investment in our analysis, we can more easily identify how changes in the social environment influence the behaviour of the members of a group or the parties to a relationship. This is also true of the changes propelled by European integration. This process makes citizens' investments less specific to their country. Thus, it affects their political activity as well as their migration choices – both directly and indirectly through national loyalty. The model presented can help us understand these mechanisms. The distinctions between the short run and the long run and between voice-related and other specific investments appear particularly important. The temporal distinction must be considered because it takes time while the level and composition of investments can be adjusted to changes in the environment. Therefore, European integration is likely to have different effects in the short and the long run. One of the main conclusions to be drawn from the model is that the weakening of loyalty and an increase in exit is to be expected primarily in the short run. In the long run, the growth of the overall level of investment by citizens' must be balanced against the lower country-specificity of these investments that appears already in the short run. While political integration tends to reduce the specificity of voice-related investments, market integration is likely to have a similar effect on other (non-voice-related) investments. Therefore, the two types of integration have a different effect on voice. While political integration makes voice more cost-efficient and thus more intensive (in the long run), market has integration has no such primary effect.

Our model shows that the consequences of the integration process are, in many respects, uncertain. However, the conditions on which the signs of its effects on exit, voice and loyalty depend can be identified. One of the critical factors is the speed of adjusting the level and composition of investments. The other factor is the degree of optimal adjustment. These factors could be the subject of empirical research in the future.

Chapter 4

European political integration is perhaps best understood as an effort to sustain co-operation among nation states. European national governments face the dilemma of collective action whenever they want to engage in co-operation. Even two private parties may face serious obstacles to mutually beneficial co-operation. One or both parties may find it rational to break their promises if they are uncertain about the performance of the other party. The parties must find ways to show their credible commitment to keeping their promises. The usual way to do this is to rely on a third-party enforcer, that is, to write a legally enforceable contract. Unlike private parties, national governments have generally no recourse to a third-party monopoly of legal force in the international arena. They must seek other ways to secure credible commitment. Arguably, the European Union is just such a mechanism for mutually credible commitment.

According to Tallberg (2003), national governments are both principals and agents in the process of European integration. As principals, they consent to co-operation and delegate the implementation of their agreements to themselves as agents. Although all countries would be better off if all of them implemented the agreements, each of them has an incentive to free-ride on the others. Each country is better off if all the others comply except for her. And when the others do not comply, she is also better off not complying. That is, national governments as agents face a classical prisoner's dilemma with multiple players. It can be argued that European national governments created the supranational institutions of the EU in order to overcome this dilemma. The European Commission and the European court of Justice should be understood as third-party enforcers or, in Tallberg's terminology, supervisors of national governments as agents. Before continuing by investigating in more detail what 'third-party enforcement' or 'supervision' means in this case, it is necessary to make it clear why national governments would wish to co-operate in the first place.

Courts of national private law help co-operation among private parties in two principal ways: (i) they enforce contractual promises, and (ii) fill in the gaps left in contracts. The more long-term a contract, the more gaps it is likely to contain. As Doleys (2000) points out, the Treaty of Rome (the founding treaty of the European Community) can be perceived as an incomplete contract, providing very general and vague guidelines for long-term co-operation. Seeing the subsequent need to both 'fill in' the details and enforce its terms, the consenting parties created third-party agents in the form of the European Commission and the European Court of Justice (ECJ) to fulfil these tasks. Gap filling and enforcement are, however, not the only and, perhaps not even the primary, activities of these institutions.

Contracts play different roles in short-term exchanges of standardised goods than in long-run relationships characterised by uncertainty and large idiosyncratic investments. For the latter, the continuation of the relationship is often preferred by the parties to the precise enforcement or judicial interpretation of the contract. To facilitate the survival of their relationship, the contracting parties develop various mechanisms of governance enabling adjustments to ever-changing circumstances (Williamson 1979). Mechanisms of mutual adjustment may work when the number of parties is relatively small. When contracting parties are numerous, however, it may be sensible to replace or supplement such a mechanism by managerial authority. By definition, a manager is entitled to make unilateral decisions within certain limits without asking all contracting parties to consent to each decision. In this fashion, the ECJ 'applies' the provision of the Treaty to specific cases, while the Commission manages the integration process through its authority of agenda setting and wide discretion of policy enforcement and implementation.

The assignment of managerial functions to the European Commission raises two questions: (i) How can national governments as principals control the Commission as their agent? (ii) How can the Commission control the activities of national governments?

We are in this paper primarily interested in the second question. Nevertheless, we cannot ignore the first question as the two are intimately related. Tallberg (2003) devotes a monograph to this first question. He argues that while national governments are interested in limiting the autonomy of the Commission to the tasks they voluntarily and collectively assign to it, the latter is interested in expanding its (formal and informal) authority beyond these limits. The national governments' concern about a 'runaway' Commission largely determines the rules of the game which all parties are expected to obey. Although the Commission can sometimes go beyond its assigned authority, it cannot change it fundamentally. For regional policy, the most important constraint on the Commission is that it must leave decision-making on individual projects and their implementation to national governments (Blom-Hansen 2005). This constraint puts severe limits on the Commission's ability to control the activities of national governments. The constraint is fundamental in the sense that, even if accept the view of a 'runaway' bureaucracy in Brussels, we cannot deny that the Commission cannot ignore its existence during its efforts to extend its influence. Bearing this in mind, we are now ready to turn to the second question: How can the Commission control the activities of national governments?

In a recent analysis, Blom-Hansen takes the view that EU control mechanisms are weak and the 'EU appears largely impotent' (2005: 637). He considers whether the EU can employ the four usual control mechanisms identified in the principal-agent literature: (i) selection of agents, (ii) designing the agent's contract, (iii) monitoring the agent, (iv) sanctioning agency drift.

Blom-Hansen argues that the Commission cannot choose its agents since it is stuck with the member states. It has little room to design its 'contract' with member states so as to reduce their discretion. There are three reasons for this. First, the member states' mandate is broad and is subject to legal rules that are either non-binding or difficult to control in practice. Second, the programming principle prevents the Commission from using economic incentives to guide national policies. Third, although the partnership principle could in theory constitute a control mechanism by enabling the involvement of selected actors favoured by the Commission, national governments have wide discretion in implementing the principle according to national rules and practice (Council Regulation 1260/1999: Article 8[1]). Monitoring is the only instrument on which the Commission can effectively rely. There is monitoring of both police-patrol and fire-alarm types. Police patrol monitoring includes national monitoring committees, ex-ante, mid-term and ex-post evaluation by independent experts as well as annual and final status reports to the Commission. Fire alarm oversight includes the partnership principle, special investigations by the European Court of Auditors as well as protests by the European Parliament, the Committee of the Regions and the Economic and Social Committee. However, monitoring is not supplemented by effective sanctioning. Although the Commission can impose sanctions on illegal agency drift, it cannot do so for non-criminal non-compliance, which is far more important. Blom-Hansen argues that 'information gained from monitoring is only useful if the principal can apply *negative sanctions* against the agent in case of non-compliance' (635; emphasis added) and, therefore, concludes that the Commission cannot effectively prevent national governments to renege on the goals of the EU.

I propose that, although Blom-Hansen is right that monitoring is the Commission's key control mechanism, he ignores other methods that equip the Commission with more effective means of control. The *institutional set-up*, which also enables close monitoring, is crucial in this respect.

EU regional policy is prepared and implemented by a distinct institutional network in each member state. Although legally all public bodies involved in the implementation of EU policies are part of the member state administration and subordinated to their national government, they are clearly very different from other parts of the national public administration. Their activities are tightly regulated by EU regulations, guidelines etc.

Working for such agencies requires *specialised expert knowledge* and even acquaintance with a *distinct thinking mode and language*. One need only be a citizen of a European country to be aware of the existence of a bureaucratic jargon of the European Union. But it is not only the jargon that serves as an outer communication obstacle. 'Brussels' generates its *own policy discourses* that structure the thinking of 'eurocracy'.[1] In addition, the direct implementation of EU policies require a special thinking mode that is alien to traditional public administration: the planning and control of activities through *project management* (Rapcsák – Heil 2002).

By participating in the establishment of a new institutional network especially dedicated to implementing EU policies, the European Commission has *de facto* been able to select its agents within national administrations. It has not relied on existing organisations but has instead created new ones. Although the details of the actual institutional set-up and the various control processes are designed *by the member states in co-operation* with the Commission, the agencies created are likely to attract employees who are more trustworthy implementers of EU policies than ordinary civil servants. There are two reasons why this should be expected. First, people tend to prefer jobs in organisations with whose goals they agree. Eurosceptics are less likely to apply for a job at a Structural Funds agency than euroenthusiasts. Second, working as a 'eurocrat' requires special personal investment in both abstract and day-to-day EU expert knowledge, which is not convertible in jobs that have nothing to do with the EU. As a result, a separate labour market for EU experts emerges.

In terms of principal-agent theory, the Commission is able indirectly to select agents within national administrations with preferences close to its own. And the more closely the agent's preferences resemble the preferences of his principal, the lesser the need for costly monitoring and enforcement. Moreover, career concern may play an especially significant role in public administration due to the weakness of formal incentives. By creating a labour market for EU expertise, the Commission indirectly creates financial and reputational incentives for its national agents. In terms of Blom-Hansen's categories, the Commission can rely on the *selection of agents* and the *sanctioning of agents* as means of control.

[1] A good example is provided by the Guideline for Structural Funds which determines the rationale of EU regional policy (EC 1999).

Discussing conflicts between a higher-level and a lower-level government, Gillette (2001) argues that ‘overlapping officials’ may help mitigate such conflicts. Public officials with multiple roles will consider the consequences of their actions for each level of government. National implementers of EU policies play exactly such dual roles. For example, Egeberg et al. (2003) have found that a considerable proportion of national officials who participate as delegates in EU committees evoke ‘multiple loyalties and allegiances’.

The control mechanisms of the European Commission we have identified are more readily available in Central East European countries which have recently joined the European Union. There are two main reasons for this: (i) The role of the Commission in institution building, and (ii) some specific features of the labour market for EU experts in these countries.

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