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Principal-agent problems in international organizations

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Abstract The paper provides a framework for analyzing control problems in international organizations and reviews the disparate evidence from a public-choice perspective. Most examples concern the European Union, the International Monetary Fund, the World Bank and the International Labour Organization. International organizations suffer from principal-agent problems more than other public or private organizations do because the chain of delegation is more extended. As survey evidence demonstrates, the actors in international organizations do not share the preferences of the citizens because they have vested interests, and the citizens believe that they have least influence at the international level. The paper argues that national and international parliaments, the national governments and international supervisory boards or courts cannot solve the principal-agent problem due to severe information cost and weak or distorted incentives.

Keywords International organizations · Principal-agent problem

JEL codes H79 · H11

1. Introduction

According to a recent analysis, the staff of international organizations has grown at an annual rate of 3.2% since 1950, while the number of member states has increased by only 2.5% p.a. (Vaubel, Dreher, & Soylu, 2005).[1] Even if the changes in the tasks or competencies of international organizations are taken into account, staff size responds to the number of member states with

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[1] This is an average of 24 major international organizations. Many others were tried but did not supply the requested personnel data.

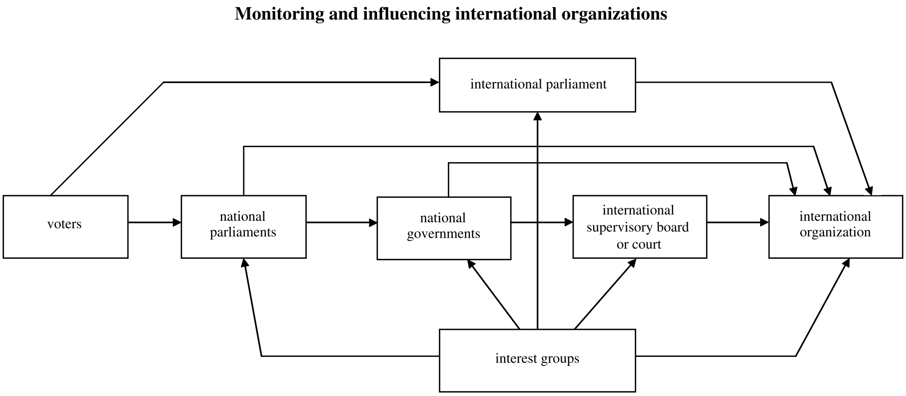

Fig. 1 Monitoring and influencing international organizations

an elasticity of 1.4 which is significantly larger than 1.[2] This is either due to technical diseconomies of scale, e.g., a larger than proportional increase in the use of resources for internal co-ordination, or to principal-agent problems, i.e., a lack of control.[3]

The flow chart of Fig. 1 visualises the principal-agent problem of international organizations. The executive of the international organization is farther removed from control by the ultimate principals—the citizens and voters—than any other political actor.

The citizens elect their national parliaments. The national parliaments choose the national executive (except for presidential systems where the head of the national executive is directly elected). The national executives may appoint a group of representatives who are supposed to supervise the international organization (e.g., a Board of Executive Directors) and/or some special court. In a small minority of cases, e.g., the European Union, the Council of Europe and NATO, there are also parliamentary assemblies attached to the international organization. Usually, the chain of delegation from the citizen to the international executive involves three intermediate bodies of control, i.e., four separate principal-agent relationships.

2. The Overall Principal-Agent Relationship: Voters versus International Organizations

The principal-agent problem is due to the fact that the international organization has vested interests which differ from the preferences of the voters and that the voters cannot effectively control the international organization because they are rationally ignorant of most of its activities and/

[2] The elasticity has been estimated from panel data.
[3] As will be explained in Section 3, their test shows that staff growth is actually due to a control problem.

Table 1 Preferred levels of decision-making for the three most important issues in ten EU member states (percentages based on responses)

Preferred governmental level	Mass public	Members of national parliaments	Members of European parliament
Regional	12	7	3
National	45	48	43
European	42	44	54

Schmitt and Thomassen (1999), European Representation Study, Table 3.1.

or lack the power to impose their will. The international agents are interested in the survival and growth of their organization: more staff, a larger budget and increasing competencies. They use their resources to further these aims. Hence, the larger the organization, the faster its growth. The mere existence of the organization alters the political equilibrium. Events which otherwise would have had no consequences provide opportunities for the expansion of the international organization. Thus, it is easier to maintain an international organization than to found it, and it is easier to found it than to abolish it. As Gottfried Haberler (1974: 156) has once put it, "international institutions may change their names or lose their function but they never die."[4] Since international organizations push for their expansion and oppose all cutbacks, they grow even if the demand for their services oscillates around a constant mean.[5]

Table 1 documents the basic hypothesis that the agents of international organizations want to have more competencies than the citizens wish to confer on them. It reports survey results of the European Representation Study in the three policy fields considered most important by the citizens (Schmitt, & Thomassen, 1999). As can be seen, an international (here: EU) competency is desired by 54% of the Euro-parliamentarians but only 42% of the citizens. The national parliamentarians are exactly in the middle (48%). The Euro-parliamentarians are so opposed to decentralization that they dislike regional (subnational) competencies even more than the national parliamentarians, let alone the voters, do.

Apart from the difference in preferences, the information asymmetry between the citizens and their international agents is important. It is due to high information cost and a weak incentive to be informed.

The high cost of information is, first of all, due to sheer distance: the seat of the international organization is usually much farther away from the citizen than the seat of her national or regional government. Second, the international organization uses a language (or languages) which most citizens do not

[4] The best examples are the IBRD, the OEEC (now OECD), the IMF and the BIS. The IBRD and the OEEC had been in charge of the Marshall Plan and European reconstruction after World War II. The IMF was established to run the Bretton Woods system of exchange rates which collapsed in 1973. The BIS was founded to handle the payment of German reparations after World War I. According to Haberler (note 17a), it "had been solemnly declared dead and ordered to be interred (in an annex by the Bretton Woods charter for the IMF), but is still very much alive."

[5] For a formal demonstration see Vaubel (1994: 158).

Table 2 Question: How much influence, if any, do you think the opinion of people like yourself have on the decisions taken by

	a) The government of your country?	b) The institutions of the European Union?
No answer	0.2	0.3
Great deal	5.4	3.9
Some influence	23.4	15.6
Not much influence	38.1	34.4
No influence at all	29.2	40.0
Don't know	3.6	5.5
Total	100.0	100.0
Number of answers:	17,298	

Source: Eurobarometer 44.1, Nov./Dec. 1995, question 73.

understand. Third, the centralization of policies at the international level reduces the scope for comparing the performances of different political agents ("yardstick competition"). Fourth, since direct parliamentary control of the organization is usually lacking, decisions tend to be taken behind closed doors: neither the minutes nor the voting record are published.[6] Thus, the individual decision makers cannot be held accountable by the citizens. The principals do not even know the arguments which have been discussed. The weak incentive to collect and exploit political information about the international organization is due to centralization as well. The citizen has less access to decision makers in an international organization, the weight of the individual vote is reduced, and his share in the savings to be reaped from cost cutting measures is also smaller than at the national or regional level. Once more, an opinion survey in the European Union (1995) confirms the hypothesis. As Table 2 reveals, 40.0% of the respondents think that they have no influence at all on the decisions taken by the institutions of the European Union—compared with 29.2% with regard to the decisions of their home government. 28.8% believe that they have some or a great deal of influence on the home government but only 19.5% say this for the European Union.

The costly supply of, and weak demand for, information explain why voters are rationally ignorant about centralized political decision making. Dahl and Tufte (1973, Table 4.8) were the first to show that the citizens believe to be less informed about national politics than about local and state politics. For those who said that they were not or hardly informed, the ratio between national and local politics was 51:39 = 1.31 for the U.K., 51:33 = 1.55 for the U.S. and 39:25 = 1.56 for West Germany.

There seem to be no comparable studies for international organizations, nor has the actual knowledge of voters been compared between international and national politics. But the citizens' ignorance of the European Union has repeatedly been

[6] Until 1997, the IMF did not even publish its agreements with the borrowing governments. Now they are published unless the borrower objects. In the European Union, the voting record of the Council of Ministers was kept secret until 1993 when the Council adopted its new Rules of Procedure. The voting record since then has been analyzed by several authors—for a survey see Vaubel (2004: 57f.). The European Commission still does not publish its voting record.

demonstrated. In 1993, for example, a Eurobarometer survey revealed that 33% of the respondents regarded the European Parliament, and 20% the European Commission, as the decisive legislative body, while 26% had no answer at all. People were also asked about the number of member states, the main seat of the EC institutions and the name of the Commission president. Only 8% of the respondents gave correct answers to all four questions.

The lack of information and accountability which centralization tends to bring about breeds distrust among the citizens. This is well known from surveys in federal states. In 2004, for example, people in Canada, Mexico and the United States were asked how much trust and confidence they had in their federal, provincial/state or local government. "None at all" or "not very much" said 62% in Canada, 57 in Mexico and 32 in the U.S. about their federal government, but only 29, 48 and 24%, respectively, about their local government (Cole, Kincaid, & Rodriguez, 2004, Table 8).

Centralization of policies at the international level does not only aggravate the problem of rational ignorance. It also weakens the citizens' ability to impose their will on their agents. To some extent, this is simply due to the long chain of delegation which undermines democratic control. There is a second control problem, however. Political agents are not only controlled by democratic majorities but also by individuals or minorities who leave the jurisdiction if the government does not perform well. Such "exit" can serve as a protection against excessive taxation, regulation or redistributive government spending. However, if these policies are transferred to, and equalized by, an international organization, the citizens' cost of escaping from these policies rises. This enables the political agents to unanimously raise the level of taxation, regulation and redistributive spending. In this way, the international organization establishes a policy cartel or monopoly, thus raising the price of its output to the citizens.[7]

This hypothesis is supported by cross-section analyses which report a significantly positive correlation between the share of central government in total government expenditure and the ratio of total government expenditure to GDP (e.g., Vaubel, 1994; Moesen, & van Cauwenberge, 2000). Other studies show that local and state governments are constrained by the relative size of government or taxation in neighbouring jurisdictions (Schneider, 1989; Besley & Case, 1995). For international organizations, we have only indirect evidence.

With regard to collusive taxation, the European Union provides a telling example. In October 1992, a unanimously adopted directive introduced a minimum rate of value-added tax which exceeded the prevailing rates of three member states. The directive did not set a maximum rate, i.e., it was not symmetric as one would expect if mere "harmonization" had been the aim. It raised the average VAT rate in the Union and it was designed to do so.

With regard to regulation, Eichener (1995) and O'Reilly, Reissert, and Eichener (1996) have shown that EU regulations—many of them unani-

[7] For a graphical exposition see Boockmann and Vaubel (2006, Fig. 1): The cooperative solution is characterized by higher taxation and regulation than the non-cooperative Nash equilibrium.

mously adopted—tend to be tighter than the median national regulation. Regulatory activity at the EU level has strongly increased since the internal market legislation of 1986. This suggests that the governments responded to fiercer regulatory competition. In this way, market integration leads to political integration. For this reason, the European institutions also have a vested interest in market integration.

To improve the voters' control over international organizations, some authors have suggested elements of direct or quasi-direct democracy. According to one proposal (Vaubel, 1999), the citizens would elect a (small) "Senate for Intergovernmental Competition" whose sole power would be to veto any forms of regulatory or tax collusion among governments. A qualified minority of the Senate or of the voters would be entitled to call a popular referendum. According to another proposal (Frey & Stutzer, 2006), a (large) group of "Trustees," selected from all citizens by lot, would have to approve all changes in the ground rules of the international organization. In addition, 10% of the members could demand a Trustee vote about any other issues on the agenda of the international organization or whether to recall top managers of the international organization.

3. Control by National or International Parliaments?

When the voters—as principals—are losing control, the national parliaments or an international parliament could take their place. However, this does not usually happen for several reasons.

In the European Union, all treaty changes have to be ratified by all national parliaments but they cannot be revoked by them unless this is proposed by an intergovernmental conference. Thus, the parliaments have become prisoners of their governments. The governments possess gate keeping power, they are agenda-setters. The national parliaments cannot—like the state legislatures in the U.S.—call a constitutional convention and curtail the powers of policy makers at the centre against the latter's will.

In ordinary (secondary) legislation, control by the national parliaments is almost non-existent. They cannot even determine their government's vote in the Council of Ministers (except informally in Denmark).

Where an international organization includes a parliamentary assembly, the latter always lacks the powers of a normal parliament. Even the most developed of these international parliamentary assemblies, the European Parliament, does not have the right to propose legislation or decide about the financing and the "mandatory" expenditure of the organization.

Nor are such parliaments well suited to control the international organization. They are so large that the typical parliamentarian lacks a sufficient incentive to monitor the executive. (The current European Parliament has 732 members.) What is more important, the parliamentarians usually share the executive's vested interest in centralizing policy at the international level as the European Representation Study has shown (see above). In this respect, there is hardly any difference among the parliamentarians or their factions. Almost the whole parliament is the party of centralization. This leaves little choice to the voters. It contributes to explaining why voter participation tends to be very low when international parliaments are elected. In Germany, for example, turnout has been 43% at the European election of 2004 but 77.7% at the national election of 2005.

Another sign of inadequate control is the fact that the international parliamentarians are unusually well paid. The European Court of Auditors, for example, has calculated that in 1998 the lump sum travel allowances of the EU parliamentarians exceeded the amount required for flying business class to each session by more than 30%. A pension may be obtained at the age of 60.

As the international parliament is relatively powerless and far removed from the voters and their representatives, attendance tends to be low. In the European Parliament, for example, 34% of the parliamentarians used to be absent in the second half of the 1990s compared with less than 10% in the Belgian parliament (Noury & Roland, 2002, Tab. 6).

All these observations indicate that international parliaments contribute little to controlling the international organization and that there is also a serious principal-agent problem between the international parliaments and their voters.

4. Control by the National Governments?

To the extent that international organizations are controlled at all, they are mainly controlled by the governments of the member states and their representatives. However, this control, too, is undermined by legal restrictions, high information cost and incentive problems—notably the strategy of raising rivals' costs.

An example of legal restrictions on the national governments is agenda-setting by the staff of the international organization. In the European Union, the council cannot legislate without a proposal from the European Commission. The Council may, since the Treaty of Maastricht (1993), ask the Commission to draft a proposal but the Commission has indicated very soon that it does not feel bound to respond to such requests (Commission Report SEL (95) 731, 14). Moreover, if the Council wishes to amend a Commission proposal, the required majority depends on the Commission's position. Since the international organization wants to keep its powers, its "aquis communautaire," it will refrain from proposing decentralizing measures. Thus, European (secondary) legislation is a one-way street towards ever more centralization.

The governments of the member states face high information costs and may be deliberately misled by the international organization. It has been shown, for example, that the International Monetary Fund (IMF) and the International Development Agency (IDA) use their credit potential more fully when the date of the next quota increase or replenishment approaches (Vaubel, 1991, 1996). In this way, they try to create the impression that an increase in funding is urgently needed. A former staff member in charge of financing operations at the World Bank has privately confirmed to me that such “hurry-up lending” has been “deliberate policy.”

The national governments also have an incentive problem. Any government that might take the initiative and persuade the other governments to cut the cost of the international organization has to share the benefit with all the others and reaps only a small part of it (Frey, 1984: 221). A national minister of finance has a much weaker incentive to monitor the spending of an international organization than that of his own government.

The incentive to monitor diminishes as the number of member states increases and the financing share of the most important member states declines. It has been shown, for example, that the number of IMF staff and the real administrative expenditure of the International Bank for Reconstruction and Development (IBRD) are significantly negatively affected by the financing share of the ten largest contributors (Vaubel, 1991, 1996). A more recent panel data analysis (Vaubel, Dreher, & Soylu, 2005) demonstrates that the staff numbers of 17 major international organizations bear a significantly negative correlation with the financing share of the largest contributor (usually the U.S.) provided that this country has a conservative government.

The governments of the member states may also deliberately refuse to monitor the international organization because the latter can help them to be reelected. The panel data analysis of Dreher and Vaubel (2004) shows that the IMF and the IBRD tend to give subsidized loans to their member governments especially before and after elections: before the election to help winning the election, after the election to facilitate the necessary correction by imposing policy conditions. The international organization serves as a scapegoat for unpopular policies.

The international organization may also improve the government’s electoral chances by publishing overly optimistic economic forecasts before the election. Kenen and Schwartz (1986) and Artis (1988) find that the growth forecasts of the IMF are systematically biased in favour of optimism. This may explain why the IMF forecasts tend to be less accurate than the forecasts of private institutions (Brunner, & Meltzer, 1990, Tab. 4.5). Fratianni and Pattison (1976) note that the country reports of the Organization for Economic Cooperation and Development (OECD) tend to be purged at the request of the government whose economic situation is being analyzed.

Another incentive problem is “the strategy of raising rivals’ costs.” If decisions in the international organization do not require unanimity of the member states, the majority of the more highly taxed or regulated member states have an incentive to raise the cost of the minority by imposing their own level of taxation and regulation on the rest. As the graphical analysis of Boockmann and Vaubel (2006) demonstrates, the majority will not impose the taxation and regulation of the decisive member state but a higher level. The reason is that, by raising the minority’s cost, the majority can reduce the competitive pressure which constrains their taxation and regulation. Thus, the majority of member states also raise their own taxes and regulations and impose them on the rest. Once more, the empirical results for the European Union (Eichener, 1995, O'Reilly et al., 1996, etc.) support this hypothesis. The Working Time Directive (1993), the Droit de Suite Directive (2001), the Investment Services Directive (2003) and the proposed Temporary Workers Directive are probably the best examples of the strategy of raising rivals' costs at the EU level (Vaubel, 2004).

Boockmann's and Vaubel's (2006) game-theoretic graph also shows that the strategy of raising rivals' costs can easily lead to a higher level of taxation and regulation than a tax or regulatory cartel would do and, secondly, that a member state is more likely to vote for international tax or regulatory standards if its own level of taxation or regulation is high. Evidence from the International Labor Organization supports this second hypothesis—especially if the regulation in question would raise labor cost.

5. Control by International Supervisory Boards or Courts?

Since the governments of the member states are not sufficiently informed or motivated to monitor the international organization, they frequently appoint a group of representatives at the international organization who are supposed to supervise its policies. In the Bretton Woods organizations, this has been the Board of Executive Directors. In the European Union, the governments have delegated the supervision to the Committee of Representatives (COREPR), the European Court of Justice (ECJ) and the Court of Auditors whose members they appoint.

If the supervisory institution is a court, its members are supposed to be independent once they have been appointed. This means that they should not take instructions from the governments which have nominated them. However, if the judges may be reappointed (as is common in the ECJ[8]), they may still be subservient to the government of their country. This is likely because very few of them have been judges in their home country. In 1994, for example, only 4 of the 13 ECJ judges had had judicial experience before being appointed to the ECJ (Kuhn, 1993: 195).

At present, there exist 19 international courts of justice; seven of them control an international organization (Alter, 2002, Table 1). They cannot exert influence unless their organization has been sued. If so, they have a vested interest to confer more competencies to their organization. By doing so, they increase their own influence. Moreover, there may be a self-selection bias: lawyers who advocate a strong role for the international organization may be more willing to join its court. The European Court of Justice, for example, considers itself "a motor of integration"—both market and political integration.

The executive directors at the IMF and the World Bank are career civil servants who return to their home government or central bank after a limited

[8] According to Kuhn (1993: 191), 59% of the judges are reappointed.

number of years. They are collectively appointed by the Board of Governors, i.e., the national ministers responsible for the organization, but they are known to receive instructions from their governments. The U.S. executive directors even receive specific instructions from Congressional committees (Gerster, 1993: 93, Annex 2 and 3). There are also executive directors who, by way of rotation, represent whole groups of countries. They are least likely to be controlled by their governments.

Most parliaments and voters know very little about their executive directors. According to Gerster (1993: 101), "the manner in which executive directors and their domestic authorities regularly report to parliament and the public on their participation in the Fund and the Bank is ... only poorly developed." Most documents are kept secret; not even the voting record is published (Gerster, 1993: 101–103; Irwin, 1994). To quote Gerster (1993: 107) once more, "there is an institutionalized bias against public accountability of executive directors."

The principal-agent problem is aggravated by the fact that the executive directors are not necessarily able and willing to control the activities of the staff. Once more, information is inadequate. Irwin (1994) cites two senior World Bank managers that "often the 'mushroom approach' is taken with the Board: 'keep it in the dark and feed it garbage'" and that "many would be concerned if the Board received certain documents several weeks before they were to be discussed."

The executive directors at the IMF vote on the credits and programmes proposed by the staff but they cannot amend these proposals or table proposals of their own (Martin, 2002). Thus, the IMF staff is an agenda-setter like the European Commission. Staff appointments are completely removed from the discretion of the Board of Executive Directors (Martin, 2002). The Board, it is true, determines the overall rate of salary increase for the staff but this rate applies also to the salaries of the executive directors (Irwin, 1994). The same is true for the EU Commissioners. As a result, the executive directors and commissioners have a vested interest to grant large salary hikes. In 1986, the last year for which the relevant data have been published, net salaries at the IMF exceeded gross salaries at the Federal Reserve Board, both in Washington, by 64% (Vaubel, 1991). All in all, Martin (2002) concludes that control by the executive directors is weak and decreasing.

Very high after-tax salaries are a characteristic of most international organizations and a sign of poor control. Irwin (1994) reports that, in the early nineties, salaries at the World Bank were only 5% lower than at the IMF but the difference seems to have increased in the meantime. He also notes that IMF and World Bank staff make very extensive use of first class flights over longer distances. Frey (1985: 139, Table 8.3) shows that net salaries at the OECD exceeded the net salaries of comparable German civil servants by 58% on average. Net salaries at the European Commission were even 80% higher. A more recent analysis (1995) suggests 90%. Needless to add, these salary differences are multiples of the inter-city differences in the cost of living.

Until recently, officials at the European Commission were permitted to retire at the age of 60 without any reduction in their income. After retirement, they were free to earn additional income from alternative employment without limit. World Bank officials retire at the age of 62.

6. Implications for the Role of Organized Interest Groups

Where democratic control is weak, well-organized interest groups are strong. The European Union is a telling example. Andersen and Eliasson (1991) have compared the influence of pressure groups in the European Union and its member states. They come to the conclusion that “the EC system is now more lobbying oriented than any national European system” (p. 178).

There are several symptoms. The first is the highly protectionist EU trade policy (“fortress Europe”), notably in the field of agriculture and textiles. The high subsidies for agriculture demonstrate the disproportionate influence of the agricultural lobby. According to the OECD’s 2004 survey of agricultural policies, financial support from taxpayers and consumers to EU farmers still amounts to 32% of the latter’s gross receipts compared with 18% for U.S. farmers. The “anti-dumping” policy of the European Union is also known to be unusually protectionist. In the 1970s and 1980s, the Commission assisted the steel industry in organizing a cartel with fixed minimum prices, production quota and subsidies.

A large number of organized interest groups is formally represented in the Economic and Social Committee (ECOSOC) of the European Union which, according to the Treaty, must be consulted on all pertinent legislation. Its members receive compensation from the Union budget. The Economic and Social Committee employs a staff of about 500 persons (half of them translators) who are also paid by the Union.

In addition to ECOSOC, more than 100 committees run by the EU Commission include representatives of organized interest groups (Falke, 1996: 132). This has become known as Commission “comitology.”

According to recent estimates, there are more than 15,000 private lobbyists trying to influence the Union institutions in Brussels. The total number of EU lobbyists, also from other governmental and non-governmental organizations, is estimated at 55,000 (European Voice, 2004). Since 1994, there has been an institute specialising in the training of EU lobbyists (“L’Institut Européen des Affaires Publiques et du Lobbying”).

William Peirce, an American economist, reports that 78% of the pages of the EU Official Journal cover special interest legislation (Peirce, 1991, Table 2). At the same time, about 72% of the EU budget are devoted to catering for organized interest groups (Vaubel, 1994).

The influence of interest groups increases with the power of government bureaucracy because bureaucrats do not have to be reelected like politicians (Crain, & McCormick, 1984). Centralization strengthens the bureaucracy because it weakens democratic control and because time constraints force decision-makers at the centre (say, a council of ministers) to delegate a larger share of the decisions to the bureaucracy. Therefore, interest groups support centralization, and bureaucracies support interest groups. In 2004, for example, the European Commission contributed 6.3 million euro to the financing of 30 non-governmental organizations in the field of environmental protection.

James Madison, the father of the (second) American constitution once argued that interest groups would be less influential at the federal than at the state or local level because regional interests would largely neutralize each other (Federalist Paper No. 10, 1787/1987). What he did not foresee is that the more encompassing interests would combine at the federal level, that organized groups with diverse or even partly conflicting interests would strike a deal at the expense of the non-organized groups and that both would be much more powerful than they had ever been because centralization gives the government more power over its citizens. Even today, there are authors who succumb to "Madison's fallacy."

Where interest groups are powerful, corruption is likely to be widespread. This hypothesis is supported by Fisman and Gatti (2002). Their indices of corruption bear a significantly positive correlation with the share of central government in total government expenditure. This is also what the cititzens believe. In a German opinion survey (Noelle-Neumann, 2002), 62% said that corruption is widespread at the national level but only 37% claimed the same for the local or regional level. A Eurobarometer poll in January 2004 revealed that almost two in three EU residents believe fraud against the EU budget is common and only one in five say that EU institutions are effective in fighting fraud.

Corruption has been a serious problem in several international organizations including the UN and the EU. In September 2005, a commission chaired by Paul Volcker revealed serious fraud and corruption in the UN oil for food program for Iraq. The European Court of Auditors has refused to clear the Commission's accounts each year since 1994. In 1998, for example, the Court stated that about half the accounts covering the Commission's programmes were incorrect. In 1999, the European Commission resigned because an independent committee of enquiry had found evidence of widespread fraud and corruption. In 2002, the Commission official in charge of the accounts (Martha Anderson) resigned in protest against inadequate controls. In 2003, the director of the European Statistical Office was involved in a corruption scandal and had to resign. The European antifraud office has estimated the damage from fraud at 1,500 million euro in 2004.

7. Conclusion

Government—especially big government—suffers from principal-agent problems. International organizations are part of (big) government, and centralization of policies at the international level is bound to aggravate the principal-agent problems. No governmental institution is farther removed from the attention and control of voters—the principals—than an international organization.

This is not to deny that many staff members of international organizations are highly motivated and dedicated to their cause. Lofty ideals—such as peace, international cooperation and solidarity—may play a more prominent role in international organizations than in a national civil service. However, information cost and incentive problems are much larger at the international level. In the end, staff members from so many countries and diverse backgrounds are united by the collective and bureaucratic interest of their organization.

The principal-agent costs of international organizations have to be set against the potential benefits of internalizing Pareto-relevant international externalities and of reaping international economies of scale in the production of national public goods.

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