**Regulatory Instruments and Enforcement in Regional Blocs**
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# Regulatory Instruments and Enforcement in Regional Blocs*

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Der vorliegende Aufsatz untersucht das wenig beachtete Verhältnis von allgemeinen Normen und spezifischen Regeln innerhalb eines Integrationsprozesses. Dabei wird im Fall der EG und ihrer Mitgliedstaaten nach dem optimalen Grad der Allgemeinheit ihrer Regeln gesucht sowie die jeweiligen Kosten identifiziert, die mit allgemeinen Normen respektive Einzelverordnungen verbunden sind. Darüber hinaus wird die Veränderung der Balance zwischen beiden Instrumenten im Zeitablauf untersucht. Die Analyse zeigt, dass Integration nicht alleine auf allgemeinen Grundsätzen aufgebaut werden kann und dass der Erlass von Regeln mit bedeutenden Grössen- und Breiteneffekte verbunden ist, die wiederum neue Regeln nach sich ziehen. Während zumindest im Frühstadium der Integration die Durchsetzung der Regeln zentral organisiert sein sollte, verschiebt sich die optimale Allokation von regulatorischer Verantwortung mit fortschreitender Integration, so dass sich die Regulierung innerhalb eines Wirtschaftsblockes als dynamischer Prozess darstellt. Schliesslich werden mögliche Auswirkungen einer EU-Erweiterung untersucht. Sofern die EU durch die Erweiterung an Homogenität verliert, wird mehr anstatt weniger Zentralisierung nötig sein, um eine einheitliche Auslegung des gemeinsamen Regelwerkes zu gewährleisten. Dies könnte durch zunehmend informelle Kooperation respektive informellen Informationsaustausch erreicht werden.

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*JEL Classification:* F13, F15

## 1 Introduction

Rules are pervasive. They affect every transaction and virtually any contact within modern societies. They are also a fundamental characteristic of the functioning of the machinery of the state. Rules are also agreed upon internationally by groups of sovereign nations which desire to ensure smooth and continuous cooperation among themselves. Such international agreements can either be self-enforcing or rely on other sets of enforceable rules.

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The European Union (EU), the most successful case of regional integration, prides itself for being based on a system of legally binding rules. Indeed within the EU there has been an explosive growth of such rules, estimated to run to over 85,000 pages. Why this growth? Moreover, there is an increasing number of rules governing what member states may or may not do and extra procedural rules stipulating how they should implement EU rules. Again, why this growth?

To some extent, rules have increased because integration in the EU has deepened and widened. Yet, within the European Community (EC), as opposed to the Union, the increase in the number of rules is far disproportional to the expansion of the *acquis communautaire* or the areas of competence of the EC, as specified in the EC Treaty. So the expansion of the acquis into a few new areas is not a sufficient explanation of the sheer growth in the number and variety of rules. This paper argues that one possible cause of this growth is that the application of rules generates more rules. Or, to put it differently, substantive rules generate interpretative and procedural rules.

Although political scientists have for centuries examined and debated the nature, role, need and consequences of rules within families, tribes, societies and between countries, relatively more recently the procedures for making rules and their consequences have also been extensively studied by economists (as, for example, in the theory of regulation, monetary policy-rules vs. discretion-, public choice, industrial policy, etc.)[1].

Given the pervasive presence of rules and the fact that they have been subject to detailed analysis, it is surprising that in the literature on economic integration they do not have a more prominent role. They have not been totally neglected, but on retrospect they have not attracted the same attention as other aspects of integration, particularly when bearing in mind that the prevalent integration arrangements are negotiated, rather than set unilaterally, and therefore create rules in the form of treaties. This may appear to be a sweeping generalisation, therefore, it deserves some explanation.

Of course, there has been discussion of the role of rules in facilitating or impeding the process of integration. This is particularly true in the con-

1 See for instance BECKER (1968, 1983), BUCHANAN (1972, 1975), KAHN (1971), MUSGRAVE (1959), PELTZMAN (1976), POSNER (1974) and STIGLER (1971) among many others. For a recent survey of the theory of public enforcement of law, see also POLINSKY and SHAVELL (2000).

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text of the recent interest in the literature about activist trade policies intended to bring about "fairness" in international transactions and the related questions whether the international trade system should regulate behaviour (rule-based) or results (outcome-based) (see TYSON 1992; VERDIER 1998). There is also a voluminous literature on how rules, as distinct from politics, has enabled the EU to build its common market, by curbing the interventionist and/or discriminatory measures of member states (see, for example, ROSAMOND 2000 and the references therein).

Nonetheless, not enough attention has been devoted to the question of whether the process of economic integration requires general rules or specific rules and how the application of such rules may be shared by the integrating countries or assigned to the different levels of the common institutions. This paper intends to address these issues.

In this respect, the experience of the EC provides a unique insight into the factors which appear to be significant and the problems that may be encountered. Even though the EC has long agonised about "subsidiarity" (i.e. the assignment of responsibility to the lowest possible level of government or, in an international context, the lowest possible level of policy implementation), not much economic analysis has been devoted to the issue of the nature of the rules that are/should be reserved for different institutions and the rules that are/should be concurrently enforced by the EU and its member states. To understand this last point, consider for a moment the principle of subsidiarity as expressed in Article 5 of the EC Treaty. It stipulates that

> "... In areas which do not fall within its exclusive competence, the Community shall take action in accordance with the principle of subsidiarity, only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community."

Note, first, that Article 5 limits the application of the principle of subsidiarity only to those areas that fall outside the exclusive competence of the EC. Although it seems reasonable that member states should not act in those areas where solely the Community is supposed to act, Article 5 sheds no light on the question as to why certain policy areas should belong *exclusively* to the EC.

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Second, and most importantly, subsidiarity is a poor indicator or predictor of how the EC acts in practice. Of the twenty-one EC activities and policies listed in Articles 3 and 4 of the EC Treaty, only three are determined exclusively by the EC (common agricultural policy, trade policy and monetary policy). In all the others, the EC and the member states have concurrent jurisdiction. In practice, therefore, the principle of subsidiarity is not about division of power but about joint action. Moreover, even in those three exclusive EC policies, it is member states that have the primary responsibility for implementing what is decided at the EC level. And only in just one of them does an EC institution act directly: the enforcement by the Commission of Articles 81 and 82 of the EC Treaty that refer to competition[2].

Third, subsidiarity says nothing about how the EC and the member states should share responsibilities in cases of joint action. It is too easy to say that the EC should decide and the member states should apply or implement. This does not answer the question of how much discretion should be delegated to member states in cases where the latter implement EC decisions or policies. It is also unclear whether discretion at the level of implementation, i.e. within member states, obstructs integration and to which extent. Despite the attention that the concept of subsidiarity has received in the academic literature and notwithstanding the increasing interest in the implementation and enforcement of EC rules, we have not been able to find any systematic treatment of the relationship between subsidiarity and the sharing of implementation tasks in any given policy area.

These are issues that relate to the problem of whether integration should be based on general rules or narrow rules. If the common rules are to be general, then member states would have wide discretion of interpretation and implementation. If the common rules are to be narrow and detailed, then the discretion of member states would be correspondingly more confined. But limiting the discretion of member states may cause other problems. For example, they may be prevented to act in situations where they ought to act or they may be prevented to adjust common measures to address local peculiarities.

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2 Generalisations about the EU or EC are always fraught with risk because there are many exceptions in their rules and in what they do. The Commission, for example, has direct responsibility in dispensing funds to eligible projects in the framework of certain cross-border programmes of regional development. This, however, is a relatively minor task which should not detract from the general validity of the statement that most implementing tasks are carried out by the member states.

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The purpose of this paper is twofold. First, it explores the costs that determine the choice between general rules (or norms) and narrow (or specific) rules. The paper is not directly concerned with the issue of subsidiarity. It does not ask when a regional bloc such as the EC should act. Rather, it considers those cases where both the supranational or common institutions and member states act and asks what may be the optimum level of generality/specificity at the regional bloc level and the member state level. Second, it identifies how the balance between general and narrow rules may change over time. The paper concludes by speculating about the consequences of the enlargement of the EU.

## 2 The growth of rules within regional blocs: The case of the EC

With the exception of the policy areas[3] that were added after the original Treaty of Rome was drafted (e.g. single monetary policy, promotion of culture), much of the current secondary legislation is based on provisions that have existed in the Treaty since its inception in 1957. This raises the question why there has been such an explosive growth of legislation? Alternatively, why have the Treaty provisions proved insufficient?

Most textbooks on the EC, dealing with its legal system or policies, offer three typical answers[4]. The first one is that general Treaty principles lack operational capability. They have to be expressed in more tangible or specific terms in order to apply to particular situations. For example, the intention which is stated in the Treaty to promote economic and social cohesion has to be translated into operational programmes or projects with money and specific goals and instruments.

A second answer is that the rules in secondary legislation are adjusted and expanded to reflect the changing circumstances and needs of the EC. For example, the convergence of technologies caused by the growth of internet has led the EC to require the separation of legal ownership of telecommunications and cable networks. This was not an issue ten years ago.

A third answer is that secondary legislation has grown to a considerable extent as a result of the demands of member states which, through speci-

3 The paper focuses exclusively on the Community or first pillar of the EU.

4 See, for example, ROSAMOND (2000) on the general trends in intra-EU integration, WALLACE (1991) on the political pressures, KOHLER-KOCH and EISING (1999) on the growth of administrative networks and SHAW and MORE (1995) on the legal dynamics.

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fic legislation, seek to neutralise perceived unfair advantages in other member states. For example, many environmental directives have been adopted out of concern that lax rules in some member states gave an unfair advantage to their producers while at the same time too strict rules in some other member states protected producers based there.

These answers are factually and intuitively correct. They tell us that rules proliferate, but they do not enlighten us very much as to how general or specific rules should be, what degree of specificity (or generality) should be pursued at different levels of the EC and who should be responsible for applying general or specific rules.

An undeniable fact is that rules continue to grow in all areas of the EC. Even where the EC has exclusive competence, there are supplementary rules on how member states should implement measures decided in Brussels. Substantive rules are frequently accompanied by side rules of procedural nature and followed by interpretative rules in the form of regulations or guidelines and notices. Although the latter are not expressed in legal language, they can still be regarded as "rules" because they are binding on the institution that issues them.

Many EU observers and commentators have lamented the rising tide of bureaucracy represented by the ever increasing number of rules. Apparently, however, not much attention has been given to the economics of the shared responsibility between the EC and member states concerning policy implementation and the optimum level of generality/specificity of EC rules applied in member states.

## 3 The nature of rules: An exploratory analysis

Before we begin formalising our analysis, it is necessary to define more rigorously the concepts used in this paper. We distinguish between "rules" and "norms". A "rule", in its simplest form, is of the following kind: "if X, then Y", where X is a single, simple, determinate fact and Y is a definite, unequivocal consequence. This relationship can be expressed in terms of a function that maps X into Y. Often rules are expressed in a way that the dependent variable, Y, may take only just two values, Y and non-Y. But it does not have to be the case for every rule.

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By contrast, a "norm" is understood in this paper to denote a more general criterion and indicates the kind of circumstances that are relevant to a decision or action and it is thus open-ended. Examples of concepts which are often used in relation to norms in the meaning of this paper are "principles", "tenets", "maxims", "primary laws" and "principal objectives". All of them denote broad intentions or definitions of general conditions and, therefore, may be considered to be equivalent to norms. For this reason they are not examined further in this paper.

It is necessary to explore in more depth the difference between rules and norms. An example will help us identify a number of significant aspects of that difference. Take, for instance, traffic regulations. Among other things, they require drivers to bring their cars to a halt whenever encountering a stop sign. The rule is: "if there is a stop sign, then any vehicle must come to a halt". There is no ambiguity as to what a stop sign is, nor is there any discretion left to the driver as to what he/she must do. A rule, therefore, is a mental devise or reasoning procedure that brings the person who uses it to an unambiguous conclusion.

Often, rules contain additional rules (rules within rules). This does not invalidate the basic feature of a rule that it leads to unambiguous conclusions. It is clear what the next step is in the decision-making sequence. This should not be confused with coercion. This paper does not deal with forced action. It examines voluntary choices. Even if a rule leads to a certain, well defined outcome, one may choose to disregard it, perhaps to his/her peril. Indeed many traffic regulations are in the form of rules because they govern human interaction in situations where ambiguity cannot be tolerated and the exercise of discretion by the drivers would lead to collisions. They are also binding in the sense that they create obligations so that non-compliance results in infringement of the law.

At the same time, however, it should be pointed out that traffic regulations require that drivers exercise due care. This is a norm. Each driver has to comply with this requirement of driving performance, which is an elastic concept. Because there are no "hard and fast rules" (note the language) when it comes to identifying all possible hazardous situations, drivers have to exercise judgement. So here we do not have rules because it is not possible (technically or economically) to enumerate and identify individually all configurations of driving situations that would pose danger to drivers. Drivers have to recognise these situations themselves. They must be alert, use their reasoning and take measures not only to avoid

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collisions, but also to reduce the likelihood of causing a collision. Their exercise of judgement implies that they have to foresee the likely future consequences of their action or inaction, as the case may be.

An important question in relation to the exercise of judgement is how do drivers recognise hazardous situations if they have not been identified or explained to them before hand? This is where most people would refer to things like "experience", "training", "common sense", etc. For example, there is no explicit provision in the statute books that prohibits driving during the night while wearing dark glasses, but obviously a court would have no difficulty assigning negligence to a driver that was found to have caused an accident because his vision was impaired by dark glasses. This is where common sense comes in. It is beyond the scope of this paper to examine how people acquire the knowledge and skills that equip them to exercise judgement and cope with the complex demands of modern life. It is sufficient to note that terms like experience, judgement and common sense connote the possession of a large amount of knowledge (information) which is not easily defined in *ex ante* terms.

What is more relevant here is the question of who determines whether "due caution" has been exercised. Precisely because there are no fast and ready rules, opinions are bound to differ. The resolution of disputes arising from conflicting opinions is left to an independent third party – the police and eventually the courts. Hence, the eventual interpretation, refinement and enforcement of norms is the responsibility of public authorities and the judicial system. In that respect, the development and enforcement by the court of case law can play a critical role.

The difference between rules and norms is in one way a matter of degree of precision. But more importantly, it is a difference that arises out of technical or economic difficulty of formulating detailed *ex ante* definitions. Eventually any rule, irrespective of how precise it is, has to be enforced by the relevant authorities. But where the enforcement of a rule may not be confined to the physical act of ensuring compliance (e.g. the policeman who issues tickets on the spot for parking violations), the enforcement of a norm requires interpretation, weighting of relevant facts and, in the end, assessment.

To conclude, the traffic examples above already allude to four important facts about the nature of rules and the delegation of responsibility (or the assignment of liability). First, and perhaps quite obviously, responsibility

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is more easily delegated when rules define precise obligations. Second, specific rules can co-exist with or complement general principles or norms. They do not have to be mutually exclusive. Third, because they require judgement, the application of norms and their enforcement usually depend on *ex post* assessment. However, norms may be applied in an *ex ante* manner as when they are used to determine entry qualifications (e.g. professional competence). But irrespective of whether they are applied *ex ante* or *ex post,* there is always someone responsible for their application in each specific situation. Fourth, the final say on whether norms have been complied with belongs to an independent arbiter, usually the courts. These conclusions have important implications for the process and nature of integration.

## 4 Norms beget rules

It was noted above that usually the courts have the final say on whether a norm is relevant to a situation or not. Not only is this generally true, but the process by which the courts expound their judgements is a dynamic one and quite crucial for the applicability of rules. This is because norms are in general clarified over successive cases dealing with similar situations. Over time, norms are complemented either by collections of more narrow or specific rules, or by case law that helps refine and clarify the interpretation and enforcement criteria of norms. Once there is a sufficiently consistent and coherent body of case law, complementary rules may not be necessary unless they serve to codify the court interpretations.

The courts may have the final say, but, of course, they are not the only ones that expound and interpret norms. Regulatory authorities do it all the time. Their methods are different from those of the courts but in at least one respect they are essentially the same: they both delineate the boundaries of the norms so as to reduce ambiguity concerning their meaning and scope of application. Courts do that through rulings that explain the scope of norms (what they contain or for which situations they are relevant), while regulators achieve the same result by defining more precise criteria or performance requirements. An example will help clarify this point.

Article 81 of the EC Treaty, which prohibits collusive practices, is applicable only when such practices "affect trade between Member States". This is a norm (or principle) because it defines the general type of cir-

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cumstances that are relevant to a decision whether a practice falls within its scope and whether, as a consequence, Article 81 has been infringed or not. Over the years, successive decisions of the Commission and the European Court of Justice have created the following rules to give operational meaning to that norm:

- the effect on trade must be "appreciable" (this term which is not used in the EC Treaty appeared in the first ever Commission decision on competition in 1963);
- only firms with a horizontal market share exceeding 5% are regarded to have appreciable effect on intra-EU trade;
- trade is affected by both the direct and indirect actions of the firms concerned;
- there is a trade effect when it can be determined with sufficient degree of certainty that the actions of colluding firms have the capability to disturb trade flows;
- the trade effect does not have to be actual, it can also be potential;
- the place of establishment of the firms is irrelevant; what matters is whether their actions affect intra-EU trade.

As a result of these rules, it is now understood that the principle of effect on trade has a very wide applicability or very wide scope. It "catches" many different practices and includes many different situations. Only the purely local actions of firms can escape its net.

It is worth noting, however, that the trade principle did not have to develop in this fashion. It could have been interpreted in a much narrower way and the subsequent rules could have been more limited. This wide interpretation stems from the Commission's and the Court's understanding of the primary objective of competition rules, which is to contribute towards establishment of the common market. They believe that any impediment or obstruction of trade is incompatible with that primary objective, even if economically it is insignificant or even if its actual impact on competition is doubtful. However, we do not intend to examine here the process by which the assumptions behind the rules that clarify norms is formulated. We only observe that such process exists and that its final direction cannot be easily predicted.

However, if there is an element of unpredictability in operation, the rules which are generated by norms, i.e. the rules that make norms operational, are very significant. It is them that make norms relevant or irrelevant, wide

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or narrow and easily enforceable or hardly enforceable. They can shape the direction of a given policy and determine the results which are in the end achieved or not.

It follows that without such subsequent rules, norms are not very useful. Hence, norms beget rules. And over time, norms become a set of "subsidiary" rules that clarify the scope of application of "primary" norms. This is a top-down perspective. We can also have a bottom-up perspective whereby if a rule is of the form "if X, then Y", or "$X \Rightarrow Y$", then the application of a norm is a task which seeks to identify situations or conditions similar to X, so that $Xi \cong Xj \cong \ldots \cong Xn$. This is because norms identify the relevant conditions from among the universe of possible conditions, while rules determine precisely the condition that prevails so as to bring to an end the decision-making process.

## 5 The role of regulation in economic integration

Having clarified the relationship between rules and norms, we can now turn to the issue of their costs and their connection with economic integration. This is not a negligible issue because, as we will show below, there are different costs involved. At this point we need to motivate our analysis of rules in the context of economic integration. What is the intuitive understanding of the role of rules in that context?

There are many theories of economic integration, both positive and normative. Since the purpose of this paper is not to put forth a comprehensive theory of integration, but rather to examine a particular aspect of it, integration may be understood, without being further elaborated, to be a process of "mutual disarmament". Independent or unilateral policy-making generates costs, either because the regulations it produces discriminate against foreign goods, services and firms or because, even when regulations are non-discriminatory, they lead to unnecessary duplication of checks and authorisations by national regulators. Multiple compliance is unnecessarily costly to firms that sell their products or operate in more than one country. Common policies remove discrimination and the need for multiple authorisation and compliance with the requirements of different systems. Even when the objective of integration is only to coordinate national policies without taking away policy-making autonomy, national discretion is still curbed, even slightly, by the need to consult partner countries before action. Common rules restrict national policy discre-

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tion because, as defined earlier, they lead to pre-determined specific outcomes.

Although there are different motives for pooling policy-making, in at least one important respect the end result is largely the same – partner countries lose part or all of their policy discretion. However, as long as there is a legitimate need (i.e. market imperfections) for economic regulation (i.e. as long as regulations do not have a purely protectionist purpose), partner countries are faced with an unavoidable dilemma. At which level of generality or specificity to fix the common rules and how much discretion to leave to the national authorities which are responsible for the implementation of the common rules? The choice of where the lines are drawn very much depends on the underlying costs and also on the available institutional mechanisms for reducing those costs.

To facilitate our analysis, it is assumed that the purpose of defining rules is to prevent private and public behaviour that reduces economic welfare. It is further assumed that the welfare of partner countries is comparable and measured in terms of the conventional sum of producer and consumer surplus. This allows us to aggregate across countries and consider the overall welfare effects.

## 6 A conceptual framework

Consider an economy characterised by distortions which are generated by market failures (e.g. anti-competitive behaviour, etc.). Assume that the nature of these distortions is such that intervention by public authorities can eliminate, or reduce, the source of the distortions. The set of policy instruments is limited to two categories: general norms, "n", and specific rules, "r". Norms consist of broad standards that address general types of behaviour and practices which are either proscribed or mandated, depending on whether they reduce or increase social welfare, respectively. As explained above, norms describe relevant conditions or situations and, therefore, need to be interpreted to apply to specific behaviour. On the contrary, rules identify specific instances which are prohibited or required. Rules are considered specific by nature and allow no (or extremely limited) scope for interpretation. They are designed to be applied in a systematic way to pre-determined instances.

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The responsible public authority (e.g. the legislator or the regulator), also called government for the sake of simplicity, is assumed to genuinely attempt to maximise social welfare and not to yield to pressure by interest groups or to have objectives which diverge from those of the public at large. Obviously, this is an over-simplification as the regulatory process is subject to strong pressures, if not capture, by specific interest groups. Indeed, to the extent that economic regulation has the potential to create rents, particular groups will attempt to collude with public officials to seek and divide up these rents[5]. Yet, as the purpose of our analysis is to identify some fundamental relationships between general and specific regulation in an integration process, irrespective of the political setting, we deliberately limit the scope of our discussion by abstracting from the pivotal role of political economy considerations, which should be the object of another study. Hence the somewhat 'naïve' assumption of a benevolent government.

Since the economy is initially characterised by distortions which reduce national welfare, the government can also be described as minimising a welfare "loss function". The loss function (i.e. the cost of distortions in the economy), "L", depends on both norms and rules; i.e. L(n, r). Yet, norms and rules which intend to reduce harmful distortions in the economy also generate costs, namely the costs of effectively enforcing them. Let this enforcement cost be denoted as "E". It is also a function of n and r; i.e. E(n, r). In order not to make the analysis too cumbersome and unwieldy, the costs generated by the legislative process are ignored[6]. Hence, the objective function of the government is to minimise the total social welfare loss function, "T", which depends on both the loss function L and the enforcement costs E, by choosing the optimal amount of norms and rules:

Objective: minimise $T(n, r)$ with respect to n, r, where
$T(n, r) = L(n, r) + E(n, r)$.

Assuming that norms and rules are well designed and do not generate undesirable negative side-effects of their own, the optimal level of instrument mix between norms and rules depends on the respective impact of norms and rules on distortions (captured by the loss function L) and on their enforcement costs (E).

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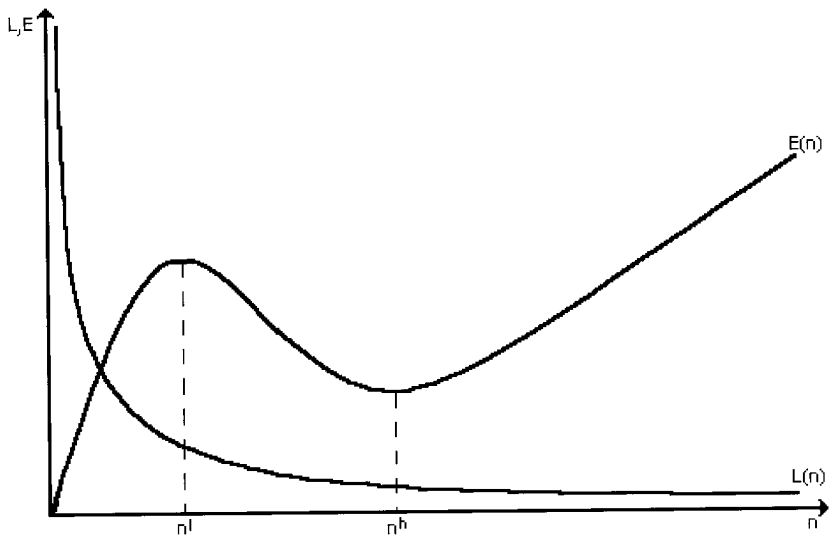
5 See BERNHEIM and WHINSTON (1986), DIXIT (1996), DOWNS (1957), MORAVCSIK (1997), POLLACK (1997) and the references in footnote 1.

6 Again, political and political economy considerations, including those related to the decision-making process, are left for another study.

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Let us consider first the loss function, L. Norms set general criteria, subject to interpretation, to prevent harmful behaviour. Hence, norms reduce the loss function: $dL/dn < 0$. Arguably, there cannot be too many norms that in the end reduce welfare (or raise L), since a benevolent and enlightened government would not design useless or undesirable norms. Similarly, norms cannot worsen distortions or introduce new distortions, as they are subject to interpretation with the objective of removing or at least reducing the negative effects of distortions[7]. Moreover, as shown in Figure 1, it is likely, although not crucial for the analysis, that the marginal effectiveness of norms decreases as more norms are defined and applied. This means that $d^2L/dn^2 > 0$.

**Figure 1** Cost Effectiveness of Norms: The welfare loss function (L) and enforcement costs (E)




The situation is more complex for rules. Contrary to norms, which are a flexible instrument that leaves room for interpretation, rules provide for a definite set of specific criteria which have to be fully implemented/respected. Their advantages over norms are clarity and certainty. The prob-

7 Note however that, as indicated by the theory of second best, the removal of only one distortion can lead to a decrease in social welfare in an economy affected by multiple distortions. Hence, well-intended measures may actually have adverse effects. Yet, for the sake of the argument, it is assumed here that an enlighted government would internalise such second-best outcomes in its decisions and in its application of norms.

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lem, however, is largely impossible to capture *ex ante* all possible events by specific rules. Hence, while the government attempts to design rules as precise as possible, it constantly runs the risk of setting rules which are either *over-inclusive* or *under-inclusive.* A rule is over-inclusive when it catches innocuous activities together with harmful ones, whereas it is under-inclusive when it allows harmful activities to go unchecked. Note that the same rule can be over-inclusive in some instances and under-inclusive in others. In general though, when there are only few rules they are likely to be under-inclusive, whereas too many rules are likely to lead to over-inclusion. Both under-inclusion and over-inclusion have negative welfare effects. Under-inclusive rules are easily avoidable but avoidance is not costless. So they do not reduce distortions while they induce firms to take costly evasive action. By contrast, over-inclusive rules raise compliance costs to an excessive level. The task of the legislator or the skill of the regulator is to identify rules which are neither over-inclusive, nor under-inclusive.

It follows that the marginal effect of rules on distortions (captured by dL/dr) is positive (i.e. they worsen) when there are either too few rules (when $r < r_l$) or too many rules (when $r > r_h$). In our notation, the subscripts "l" and "h" stand for the low and high values of r, respectively.

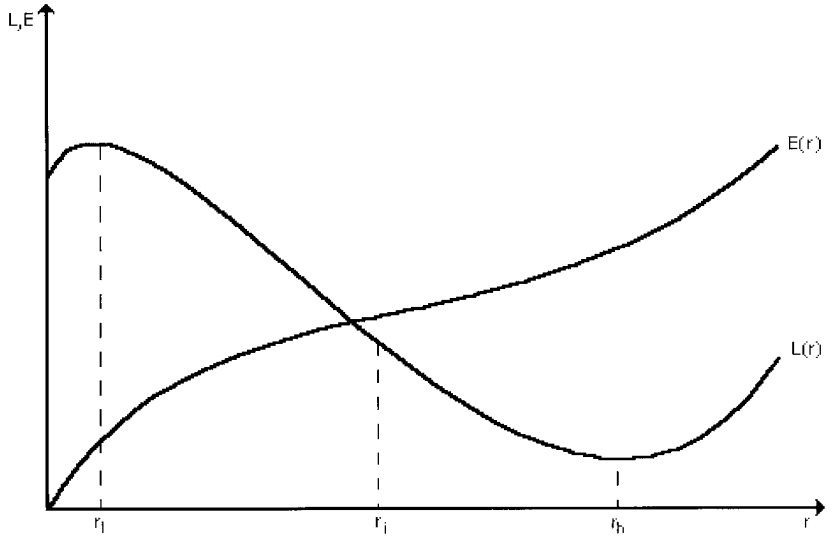
*Formula 1*

$$dL/dr \begin{cases} \geq 0 & \text{when } r \leq r_l \\ \leq 0 & \text{when } r_l \leq r \leq r_h \\ \geq 0 & \text{when } r_h \leq r \end{cases}$$

When a "critical mass" of rules is achieved ($r_l$), rules become sufficiently comprehensive and reinforce each other, leading to an effective reduction of distortions. But too many rules (i.e. above $r_h$) crowd-out the system, as they are inflexible and not subject to interpretation depending on the circumstances (contrary to norms). Note that rules are adopted by a benevolent government only if they reduce distortions, which implies that $L(r = 0) > L(r_h)$. Besides, it is likely that $d^2L/dr^2 < 0$ when $r < r_i$, and $d^2L/dr^2 > 0$ when $r > r_{i,,}$ where $r_i$ denotes the inflection point. Figure 2 illustrates this situation.

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**Figure 2** Cost Effectiveness of Rules: The welfare loss function (L) and enforcement costs (E)




Let us now turn to the issue of enforcement costs. Indeed, the optimal amount of regulation depends not only on the potential benefits from reducing distortions, but also on the cost of enforcing norms and rules to this intent, E(n, r). For both norms and rules, two effects are at work: a "cost effect" and an "economies of scale/scope effect". The cost effect is an obvious one. As more regulations are put in place, more resources to enforce each norm or rule are required. This effect would prevail if each regulation (norm or rule) were enforced independently from the others.

However, regulations often complement one another. As a result, the average cost of enforcing legislation falls as more norms and rules are applied, to the extent that they facilitate their mutual enforcement. When new rules facilitate the enforcement of existing rules, and new norms the enforcement of existing norms, then we have economies of scale in enforcement. When more rules facilitate the enforcement of norms, and more norms ease the enforcement of rules, then rules and norms are complementary and we talk of economies of scope in regulation.

Two cases can now be envisaged. In *case I*, the economies of scale are sufficiently large to overcome the direct cost effect so as to reduce the total enforcement costs, at least over a certain range, defined as ($n^l$; $n^h$) for

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norms and ($r^l$; $r^h$) for rules. Hence, the first derivatives for norms and rules are, respectively:

*Formula 2*

$$dE/dn \begin{cases} \geq 0 & \text{when } n \leq n^l \\ \leq 0 & \text{when } n^l \leq n \leq n^h \\ \geq 0 & \text{when } n \geq n^h \end{cases}$$

*Formula 3*

$$dE/dr \begin{cases} \geq 0 & \text{when } r \leq r^l \\ \leq 0 & \text{when } r^l \leq r \leq r^h \\ \geq 0 & \text{when } r \geq r^h \end{cases}$$

Note that as both norms and rules are costly to enforce, it follows that $E(n = 0) = 0 < E(n^h)$ and $E(r = 0) = 0 < E(r^h)$. Economies of scale cannot eliminate all costs of enforcement. The same logic applies to economies of scope.

Alternatively, in *case II,* the economies of scale are not sufficient to decrease the overall cost of enforcement: $dE/n > 0$ and $dE/dr > 0$. However, over a certain range, the average cost of enforcing regulation could decrease due to the economies of scale (respectively scope) effect. The total enforcement cost function increases in a non-monotonic way; for instance, $d^2L/dn^2 < 0$ when $n < n^i$, and $d^2L/dn^2 > 0$ when $n > n^i$ (and likewise for rules, r).

When considering enforcement costs, the analysis so far has treated norms and rules in a symmetric way. However, it seems that norms are more likely to exhibit the characteristics of *case I,* where economies of scale prevail, whereas rules would better fit *case II,* with a dominating enforcement cost effect, as illustrated by Figures 1 and 2. The reasoning is the following. Compared to rules, norms require more effort and information costs to enforce, as they have to be interpreted. That is, each instance has to be considered on its own merit and assessed in view of the guiding norms. However, at some point a sufficient number of norms will make it easier to evaluate each case. At that point norms reinforce each other and economies of scale prevail. Rules, on the contrary, are directly applicable. That is, while the enforcement of norms is greatly facilitated by previous experience, case law and the interpretation of other norms, all sources of

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economies of scale and scope in enforcement, rules are enforced according to their own strict (often binding) pre-determined criteria.

Going back to the optimisation problem, the task of the government is to minimise the objective function $T(n, r) = L(n, r) + E(n, r)$ by choosing the optimal level of norms and rules, knowing that $dT/dL > 0$ and $dT/dE > 0$. The first-order necessary conditions can be expressed as:

(1) $dT/dn = (dT/dL)(dL/dn) + (dT/dE)(dE/dn) = 0$, and
(2) $dT/dr = (dT/dL)(dL/dr) + (dT/dE)(dE/dr) = 0$.

With respect to norms, it follows from equation (1) that: sign $dL/dn$ = – sign $dE/dn$. Since $dL/dn < 0$, then at the optimum, $dE/dn > 0$. This is an interesting result if over a certain range norms exhibit strong economies of scale in enforcement (i.e. $dE/dn < 0$), as envisaged in case I. Indeed, this would suggest that the optimum amount of norms, $n^*$, is either relatively low, $n^* < n^l$, or high, $n^* > n^h$. An intermediary solution, where $n^l < n < n^h$, can never be an optimum as the adoption of more norms reduces social costs ($dT/dn < 0$).

At this stage, two important lessons can be drawn. First, although norms reduce the harmful effects of distortions, their enforcement has a cost which should be taken into consideration when determining the optimal level of regulatory intervention. Too many norms may become welfare reducing, even if they eliminate distortions in the economy. A corollary to this result is that the presence of harmful distortions in the economy is not a sufficient condition to justify regulation. Although this point is rather obvious, it is often neglected or even ignored when deciding on the need for new regulation or when existing regulations are assessed[8]. Second, assuming that there is an equilibrium such that $n^* > n^h$, the presence of economies of scale in enforcing regulation could explain why over time an increasing number of norms are adopted. With a gradual adoption of norms, moving from $n^l$ to $n^h$ allows to take full benefits of the potential economies of scale of a set of norms[9].

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8 For an empirical discussion on the evaluation of regulations, see HAHN ET AL. (2000).

9 An interesting situation could also arise in the presence of an optimum such that $n^* < n^l$. Imagine that the government produces more norms than the optimal level, for political reasons for instances, say at $n^l$, and that reducing the amount of norms (e.g. in a process of simplification of legislation) is (politically) difficult (as commonly observed). Of course, this phenomenon of (irreversible) over-production of legislation would require a relaxation – if only for that instance – of the assumption of a perfectly enlighted government. Then, the government would be well advised to pursue the adoption of norms even further, at least up to $n^h$, in order to take advantage of the economies of scale. Such a process of

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Turning our attention to rules, equation (2) implies that, in the absence of strong economies of scale as envisaged in *case II,* the optimal amount of rules, r*, is such that rules must reduce distortions, dL/dr < 0, and therefore $r_l < r^* < r_h$, since sign dL/dr = – sign dE/dr. While a critical mass of rules is required to be effective (at least $r_l$), too many rules (above $r_h$) are detrimental to social welfare. Of course, the larger the economies of scope/scale in enforcing rules, the higher the optimal amount of rules (around $r_h$). Similarly, the presence of significant economies of scope in regulation would lead to an optimum with more rules.

Finally, comparing norms and rules, it follows from equations (1) and (2) that

$$\text{sign } (dL/dr - dL/dn) = - \text{sign } (dE/dr - dE/dn).$$

We know that dL/dn < 0 and dE/dr > 0, and that at the optimum, dL/dr < 0 (in *case I*) and dE/dn > 0 (in *case II*). Therefore, if norms require marginally more effort to enforce than rules (dE/dn > dE/dr), then norms must be more efficient than rules at reducing distortions (dL/dn < dL/dr < 0). The reverse is also true.

Finally, the overall efficiency of regulation is further enhanced when rules significantly facilitate the implementation of norms (i.e. exhibiting strong economies of scope).

To summarise, our analysis leads to the following conclusions:

(a) efficient regulation requires the use of both general norms and precise rules;
(b) norms and rules are imperfect substitutes for each other;
(c) there appear to exist critical values for norms and rules that determine their impact on overall welfare; regulators need to discover those values;
(d) too little regulation may be as "bad" as too much regulation;
(e) it is likely that the application of norms and rules benefits from economies of scale; it appears that such economies are stronger in the case of norms rather than rules;
(f) norms and rules become complements when regulations exhibit economies of scale.

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proliferation of norms could be even more likely in the presence of multiple equilibria, limited to two in this framework, where $n_1^* < n^l$ and $n_2^* > n^h$. Of course, the above comparative static approach is only indicative, as we do not attempt here to formalise the dynamic of rule making.

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These conclusions have significant implications for the design of integrationist frameworks and the allocation of regulatory tasks between the common institutions and the partner countries. The next two sections explore these implications.

## 7 Implications and extensions

An immediate and perhaps trivial observation can be made from the analysis in the previous section. Legislation alone is not a panacea. The administrative cost of enforcement has to be taken into account. Moreover, regulatory effort and rule-making have to take place both at the statutory (formal) level and the enforcement (informal) level. This is how the efficiency of using society's resources is maximised. So, efficient integration requires that we pay attention both to the overall principles and norms of integrationist arrangements and the lower-level rules of policy implementation.

### 7.1 General norms versus specific rules

One of the objectives of legislative and regulatory activity is to reduce or prevent harmful behaviour by economic agents. This can be achieved by relying on general instruments of regulation, norms, and specific ones, rules. General principles and norms have the advantage of being flexible, and therefore to be more comprehensive in their coverage. The flexibility they entail also allows for precise targeting of harmful behaviour, as compliance with regulation is sought with respect to the spirit of a principle rather than with the letter. Hence, in the case of norms it is possible to avoid unintended negative side-effects. This requires of course interpretation of the norm.

Interpretation resulting from the flexibility of general norms is both the strength and the weakness of this regulatory instrument. While interpretation allows for adjustment and precise matching between the harmful behaviour and the remedy proposed, it can also generate serious drawbacks. First, to be effectively enforced, norms demand sufficient effort and resources. That is, the flexibility provided by interpretation comes at a cost. Second, flexibility can also become the source of uncertainty. How will the norm be applied (or interpreted)? When decisions are taken by different regulators or over time or under different circumstances, issues

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of inconsistency may arise: a norm may be interpreted one way in one case and a different way in another case.

Detailed rules, on the other hand, provide for greater certainty as their application is more predictable. By relying on a specific set of pre-determined criteria, they ensure greater consistency in their application. They can also appear more effective in the sense that their enforcement is less costly: it is easier to prove compliance (or breach) with clearly defined rules. However, as already mentioned, rules can become either too deterministic, hence providing loopholes for harmful behaviour falling outside the narrow scope of the rules (the under-inclusiveness of rules), or they can be too wide in their scope thus targeting innocuous behaviour (the over-inclusiveness of rules). Both situations yield counter productive effects.

To repeat, the task of the legislator and the regulator is therefore both to determine the appropriate level of regulation and to strike the right balance between broad principles and specific rules. To do so correctly, the ultimate objective must remain that the benefits from the controls imposed by regulation (either norms or rules) in reducing or preventing harmful behaviour outweigh the costs incurred from enforcing regulation.

Consider now what may determine the "right balance" between norms and rules. Many answers have been given in the literature to this question[10]. One predominant answer that has primarily come out of the literature on financial regulation is that that balance is determined by whether the effects of the underlying distortions are observable *ex ante* and whether they are reversible or not[11]. If, for example, consumers cannot distinguish between financial sound and unsound providers of pensions and if they can discover whether their premiums over the years have been managed prudently only when the time comes to draw their pension, then it will be too late for both them and the regulators to act. When the effects can be observed *ex ante*, then distortions do not cause a major regulatory problem because even if they are irreversible they can be avoided. Similarly, non-*ex ante* observability is not a problem when the effects can be reversed once they are realised. When both conditions prevail the literature suggests that regulators have to rely on specific rules. They cannot af-

10 See TIROLE (1988) on regulation in general, DIVER (1983) on the precision of rules and BECKNER and SALOP (1999) on the choice of rules to be followed at each stage of the enforcement of regulations.

11 See, for example, BENSTON and KAUFMAN (1996) and LLEWELLYN (1999).

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ford either to allow discretion in the system or to wait to evaluate events *ex post*.

In addition, our analysis in the previous section suggests that there is at least another factor that has a significant bearing on the optimum balance between norms and rules. This is the possibility for economies of scale and/or scope. As we have already explained, such economies are caused by potential reinforcing effects and complementarities. If these effects are stronger for norms then there will be greater reliance on them. If they are stronger for rules, then rules will be used more extensively.

As norms are subject to interpretation, they are more likely to exhibit economies of scale/scope. Past interpretation or interpretation of a similar broad criteria present in various norms can reduce the cost of interpretation, and therefore the marginal cost of enforcement. As lessons are drawn from common practice, the interpretation of norms may become more standard. Ultimately, some of the interpretation criteria of general principles can be formally codified, leading to the adoption of new rules. Hence, some specific rules can be seen as a complement to general principles.

It is important to note, however, that a codification of the interpretation of norms is not a necessary feature to reduce enforcement costs. Indeed, as more decisions are taken under norms, a standard interpretation can develop through case law. To the extent that the body of case law is sufficiently clear and coherent, and does not lead to inconsistencies in the interpretation of norms (due to various criteria of interpretation, jurisdictional differences or revealed ambiguities in the formulation of the norms), the adoption of more specific rules may be superfluous. Hence a well developed body of case law could be a substitute to detailed rules as a mean to clarify and more effectively enforce norms. An significant caveat applies though. When interpretation of a norm by the judiciary system (i.e. the Court or regulator which sets the 'case law') differs from the intent of the legislative or rule setting regulatory body, then the codification of the norm into more specific rules may allow the rule maker to reverse or precise case law interpretation. This reflects a standard principle-agent relationship, or a balance of power between the political, legislative, judiciary and executive powers. In this respect, the level at which regulation is adopted has also crucial political implications, an issue beyond the scope of this paper (see COOTER and DREXL 1994).

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## 7.2 The dynamics of regulation

Broad principles can have limited effectiveness when first applied, but their flexible enforcement can ensure that they will not be misapplied in the sense that they will prevent harmless (or welfare enhancing) behaviour. On the contrary, specific rules which are deterministic and prescriptive can lead to welfare-reducing outcomes when, perhaps because of their narrow scope, they cannot prevent avoidance. Hence, while setting regulation, it is advisable to start with (1) some general principles and norms and (2) at least a minimum level of rules so as to enable them to have a significant positive impact. To the extent that general norms set broad guidelines which are applied sensibly in a case-by-case approach, they should not constrain innocuous activities. The problem, however, is the relatively costly enforcement of norms (in particular in the absence of strong case law). Yet, rules, if too numerous, may make the system excessively rigid.

A tentative dynamic process of regulation can thus be outlined. The main point here is that because a few norms and rules may do more harm than good, it is more efficient and effective to begin with a sufficient body of norms and rules in "one go" rather than in an incremental fashion. Once a critical core of norms and rules is established then there can be a process of gradual improvement.

First, some broad principles are adopted. They serve to identify general norms and standards to be followed, as well as to provide *ex ante* constraints on agents' behaviour to limit distortions. Although harmful activities could also be prevented on a discretionary manner, the advantage of regulation rests principally on the greater predictability of outcomes it provides. Then, as more experience is gained, more specific rules can be adopted. Specific rules thus serve (1) to codify current practice, and (2) to provide ex ante measures (and some better *ex post* remedies) to prevent deviation from the general principles and norms pursued. Loopholes can be identified and inadequate compliance corrected. Remedies can take the form of more (or revised) rules. When new problems arise, the adoption of further principles and norms can also be envisaged.

Note that the issue of timing can play a crucial role in regulatory development. As mentioned by HAUBRICH (2000) in the case of monetary policy, "timing matters if there is some possibility of *regret* that adopting rules was a bad idea, at least in the short run". In situations where the regulator

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does not possess sufficient information on the nature of harmful activities, or when an appropriate remedy measure is not clearly identified, it may be better to wait before adopting new regulation. This is even more true in the case of specific rules as they allow for less flexibility and are more deterministic than general principles. Two major reasons can justify this wait-and-see approach.

First, inadequate regulation can be counter-productive in the sense that it may fail to effectively tackle harmful behaviour or it may do so at a too high cost of enforcement. Second, inappropriate regulatory solutions may provide wrong incentives to economic agents (firms and consumers). Here is the problem of signalling. Not only must government intervention be effective, it also has to send the right signals to the economy so that agents will believe the objective pursued by the government. For instance, too harsh or complex regulation may discourage entrepreneurs. But then why should the regulator worry about regretting his decision? If so, the regulation (rules or principles) can always be amended or abolished.

This raises the issue of credibility of the regulator and the question of predictability and stability of the regulatory environment. Again, constantly changing regulation is not conducive to trust the government in its desire to tackle harmful activities. Indeed, some of the main benefits from the rule of law are to reduce uncertainty, to limit government arbitrariness and to favour closer political accountability (see SEIDENFELD and ROSSI 2000). All these objectives will not be served if there is no stable regulation. This does not mean that the regulatory environment should be static. Rather, regulation today also sends signals about future regulation and future actions by the regulators. Changes have to be seen by the "regulatees" as improvements. It has been argued in the literature that for this reason regulatory changes should in general take the form of either further interpretative regulation (as in the process described above) or of adaptation by small modification of existing legislation (see also GEORGAKOPOULOS 1996).

Yet, as the amount of regulation increases, each regulation becomes marginally less effective. Besides, too much regulation may become very complex and costly to manage, leading to possible diseconomies of scale in the enforcement costs of regulation. The problem can become particularly acute in the case of rules, since too many rules also lead to procedural and bureaucratic burden which not only generates excessive enforcement

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costs, but may also fail to address distortive activities; then, too many rules can be worse than too few rules[12].

To conclude this section, we have argued that there are good reasons to believe that effective regulatory systems develop in a gradual way rather than being established in one go. Moreover, there are also good reasons to believe that starting from an initial mix of norms and rules, additional norms and rules are developed in subsequent stages. The balance between norms and rules need not remain the same in all time periods or stages. These changes have a significant bearing on the sharing of regulatory tasks within regional blocs.

## 8 Regulation in regional blocs: The process of integration

The analysis so far could apply to a single country. How does the situation change when norms and rules are being determined within a group of countries? The two pertinent issues in this context are loss of policy-making autonomy, on the one hand, and ensuring effective application of the common policies in the partner countries, on the other hand.

Although autonomy and sovereignty are normally assumed to be political issues and represent expressions of political/national preferences, they have an important economic dimension and serious economic consequences. This is because, like everything else in life, autonomy/sovereignty comes with an opportunity cost (the forgone opportunity to influence other countries' policies to one's own advantage). It is ignored in this paper not because it is insignificant but because it has been the focus of extensive attention in the literature of integration[13]. We concentrate, instead, on the question of effectiveness that has been relatively ignored.

How and by how much should a regional bloc regulate so as to ensure effective application of its polices? The answer of course depends on the degree of integration sought by the members of the bloc. Historical, cultural, political and institutional factors will also influence the regulatory framework chosen by the nations concerned. Yet, some general properties can be identified.

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12 For a discussion on the costs associated with excessive rule-based regulation, see SEIDENFELD (1999).

13 See Best, GRAY and STUBB (2000), ROSAMOND (2000) and SCHARPF (1999) for extensive analysis of the proposals for reform of the institutions of the EU in order, among other things, to make them more democratic.

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In international cooperative agreements, a rule-based system may provide stronger incentives for governments to respect the spirit of the agreement. It may also constitute a reference (or benchmark) as to the standards and norms to conform to. The adoption of common rules by all the partners facilitates a more coherent application of such agreements. It is necessary though that rules are sufficiently clear (i.e. do not allow for contradicting interpretations) and that they are effectively implemented by all partners[14].

Note, however, that in a dynamic time-frame, tacit cooperative agreements may become self-enforcing in the presence of credible retaliation threats in a repeated game. In such a case, general principles and norms may often suffice[15]. That is, in comparing norms versus rules, it is not always the case that norms provide flexibility at the expense of certainty. General principles may generate more certainty and predictability if there exists a shared common understanding of the requirements and underlying spirit of the principle among all the partners in charge of implementing the agreement[16].

Therefore, it appears that the larger the number of partners to the agreement, the shallower the degree of both formal and actual integration because of more diverse interests, more diverse understanding of the essence of general principles, weaker incentives for retaliation against non-performing partners and stronger incentives to cheat. It follows that the more diverse the partner countries are, the more precise and explicit the regulation to be applied by the partners should be. In this case rules would be more appropriate than norms. It is not, therefore, surprising that over the years and as its membership has expanded, GATT has not only defined more rules (expanded the scope of its charter) but more significantly has produced more rules that expand, explain and refine older rules (e.g. the understanding on the application of Article VI on anti-dumping and countervailing measures).

As already suggested, an intuitive explanation of the significance of rules and the way policies are determined within regional groupings is that the process of integration is an act of "mutual disarmament" because, among

14 On the issue of effective implementation, see NICOLAIDES (2000). The enforcement of competition policy is a case in point. Japanese anti-trust law has many similarities with the American anti-trust law. Yet, the US has often accused Japan of depriving US companies of the rights of market access they obtained under GATT through lax enforcement of its anti-trust rules.

15 See GATSIOS and SEABRIGHT (1990) for an insightful discussion.

16 BLACK (1999) argues along similar lines in the case of financial regulation.

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other things, partner countries do not trust each other to formulate and manage their policies unilaterally. However, experience with regional integration indicates that mutual pronouncements of lofty ideals is not enough. This is because commonly agreed norms may not achieve their stated objectives if in practice they are not sufficiently interpreted and developed into enforceable rules by the partner countries. In addition, even commonly developed and agreed rules may fall short of stated objectives if they are not vigorously enforced. In the first instance, the central issue is one of developing rules out of norms in a way that they empower those norms (make them operational or applicable) in all partner countries. In the second instance, the central issue is one of measuring the performance of the responsible authorities in the partner countries.

In simple terms, the possible dynamic process of regulation in a regional agreement could be sketched as follows. Initially, partners agree on a minimum set of common principles and norms that they intend to pursue collectively. As they apply the agreement, they may encounter three types of "problems". First, the implementation of the agreement is not satisfactory because of the unavoidable loopholes in the agreement. The remedy can be more norms or rules to plug the holes.

Second, implementation may prove to be excessively costly and cumbersome. Note that this may happen even in the case where norms are fully respected by all parties. This is because norms need to be interpreted in each instance and therefore take up resources. Over time, the development of a well defined case law can help reduce the cost of interpreting and enforcing norms. Yet, in order to avoid to have to treat each case on its own merits, more specific rules may be drawn up to facilitate the enforcement of the agreement. Rules intend to render general principles more operational. However, as it is not possible to foresee all possible events when designing regulations, more rules and norms have to be adopted subsequently. This process of regulation proliferation will be even more pronounced when further integration is pursued by the regional bloc, thus increasing the scope of the agreement among member countries.

Third, partner countries may wilfully or by neglect fail to enforce the provisions of the agreement. To the extent that ineffective outcomes are facilitated by the generality of the agreed norms, the remedy is a further specification of the norms through more detailed rules that make it more difficult for partner countries to evade their obligations.

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But regulations need not grow forever. It is also possible to envisage a process by which partner countries gradually learn from each other and their understanding and interpretation of the norms converge over time. It then becomes possible to simplify the regulatory framework by relying more on norms and less on rules. Irrespective of whether regulations expand or contract, the point we want to highlight here is that regulation in regional blocs may not only develop over time but it may also have a cyclical nature; it may contract.

Alternatively, some member states may face particular situations or pursue different objectives than others. In that respect, norms adopted at the regional level may need to be implemented in a country specific manner so as to account for these differences. The adoption of detailed rules at the regional level to ensure a uniform application of the norms may in certain occasions turn out to be counter-productive. Hence, member states may voluntarily refrain from specifying norms in detailed rules and prefer instead to leave specific the specific enforcement of general principles to member states discretion. This may be reflected in national enforcement of norms and the development of country-specific case law.

So far we have identified two types of regulatory change in regional blocs: expansion of norms and rules over time and contraction of rules and more reliance on norms over time. But there is also a third type of change – re-allocation of regulatory tasks between the common institutions and the partner countries.

Parallel to the "learning effect" identified above, leading initially to more regulation and then to simplification of the regulatory framework, there exists a "centralisation-decentralisation effect". Although given the lone success of the EU, it appears that centralisation of regulatory responsibility through delegation to a supranational body is not a usual phenomenon, our theoretical analysis suggests that it is a more efficient approach than decentralised regulation, at least at the initial stages of integration.

The literature of integration has already identified two major reasons for centralised regulation. First, application by a central authority achieves consistency of interpretation of general principles. Second, a single, bloc-wide authority can address directly distortions without encountering jurisdictional limitations or jurisdictional conflicts with other authorities (see GENSCHEL and PLÜMPER 1997; SUN and PELKMANS 1995). However, there are also political considerations at play. The allocation of tasks be-

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tween the common institutions or central authorities and partner countries depends on the degree of discretion that those countries are willing to bestow on the central entity. Moreover, national differences in policy objectives or in the assessment of existing market failures to be addressed by regulation can also justified a more decentralised approach to regulation. A detailed discussion of such political issues is beyond the scope of this paper.

In our context, the efficiency of centralised enforcement of norms stems from the facts that (a) norms and rules tend to generate new norms and rules and (b) there are economies of scale in norm (and perhaps rule) generation. This means that if we expect the process of enforcement of common principles inevitably to generate more norms, then it makes sense to centralise that process so as to reduce costs further and enable the enforcing authority to learn faster and more systematically (through economies of scope) about the effects and limitations of the norms it enforces. Rules that are more narrow and do not benefit from strong economies of scale/scope may be left to the partner countries.

Once more, the allocation of regulatory tasks need not be fixed forever. As the norms and rules develop to sufficient number and as they become better enforced in a more homogeneous way by the partner countries, it becomes more feasible to decentralise regulatory responsibility. Moreover, sub-regional differences in policy preferences, regulatory practices and market condition may also justify a decentralised regulatory approach (respecting the principle of subsidiarity), in particular when a consensus emerges around the objectives of norms adopted in common at the regional level.

In short, the process of regional integration can lead to a cyclical pattern of regulation which depends both on learning effects and centralisation effects which contribute to more efficient generation of subsequent norms and rules, which in turn facilitate the development of common understanding of the regulations so that their enforcement can be decentralised.

## 9 Concluding remarks

This paper has sought to explore the relatively neglected issue of the balance between general norms and specific rules in processes of integration. Abstracting from political economy considerations, we argue that integra-

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tion cannot be sustained alone on general principles. It needs specific rules of the sort that would enable an implementing or enforcement authority to determine unambiguously whether an activity is harmful and, therefore, proscribed or not.

We also argue that, under certain reasonable assumptions, it is probably less costly socially, to pursue enforcement of "the regional or common law" through a mixture of general principles or norms and specific criteria or rules. For both norms and rules there is a need to start with a critical core.

Our analysis suggests that there are important scale and scope effects in the generation of norms and rules that lead to further norms and rules. These effects also indicate that, at least in the initial stages of integration, regulatory enforcement should be centralised. Decentralisation may take place at later stages of integration after sufficient experience has been gained. Hence, there is a dynamic process in regulation within regional blocs that over time changes the optimum allocation of regulatory responsibilities between the central and the national authorities. Since decentralisation is facilitated by the development of common understanding of the scope, effects and limitations of the norms and rules, formal and informal channels of cooperation and information exchange are bound to be important in regional blocs.

If the arguments that have been made above are correct, it seems to us that one of the directions of future research should be to consider the implications of the impending enlargement of the EU on the quality of enforcement of EU rules. Given that the development of a homogeneous interpretation of the common rules very much depends on the number of the countries participating in a regional bloc, the impact of enlargement on the quality of enforcement is not likely to be trivial. So far the EU has been pre-occupied with reform of its formal decision-making procedures. There has been less public discussion about the consequences of enlargement on other, less visible aspects of the functioning of the EU. If anything the focus of attention has been on the candidate countries with Commission stressing repeatedly the message that they have to develop effective capacity for implementation and enforcement.

The prevailing thinking at present is that the Commission will not be able to cope in an enlarged EU without further delegation of its tasks. But if enlargement will make the Union less homogeneous, then there will be a

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need for more, not less, centralisation. A possible resolution of this conundrum may be the growth of informal arrangements of cooperation and information exchange. They may become more and more significant as decision-making within the expanded Councils and committees of the future become more difficult, more cumbersome and more time consuming.

Besides, a comprehensive understanding of the regulatory framework in regional blocs would also require a detailed analysis of the political forces at play. While we have voluntarily refrained from explicitly discussing political economy considerations, the role of various economic and political actors in the regional integration process and its regulatory development deserves much needed further research.

And a last thought. If less formal arrangements will become more important, perhaps, what the EU needs is a principle of good performance or best practice, whereby national authorities would be expected to match the best performance of their counterparts in other member states. That would indeed introduce competition among national authorities similar to that among private firms operating within the single market.

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