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Governance Costs in Postal Regulation: Towards a Proper Definition of Regulatory Governance Costs (and its Evidence in the Postal Sector)

(Preliminary draft- do not quote – comments very welcome)

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Abstract:

The various actors in network industries relate to each other within a broader institutional framework, i.e. by way of formal and informal rules. The operation of such an institutional framework as well as its impact on all actors has a cost, which we describe as “costs of regulatory governance”. We assume that these costs are inherently present in any institutional arrangements and as such are determined (1) by the institutional design and (2) subsequently by the behavior of the various actors. According to new institutional economics, these costs will depend upon the formal and informal rules among the involved actors, upon the allocation of property rights among these actors, as well as upon the various principal-agent or more generally contractual relationships among these actors. In this rather conceptual paper we come up with a definition and define them as the *costs of establishing, maintaining and coordinating a regulatory arrangement*. We identify four categories of regulatory governance costs:

- Monitoring costs arise because of informational asymmetries in their relationships of principals with their agents.
- Compliance costs are the costs the industry face in order to comply with regulatory requirements.
- Coordination costs result from multiple institutional actors involved in regulated industries, and that the different actors have to be coordinated.
- Costs of regulatory failure occur when actions of regulators have (often unintended) negative effects on the regulated industry.

1. INTRODUCTION

The various actors in network industries relate to each other within a broader institutional framework, i.e. by way of formal and informal rules. The operation of such an institutional framework as well as its impact on all actors has a cost, which we describe as “costs of regulatory governance”. Theorists as well as practitioners have not paid enough attention to these particular costs of a regulatory arrangement so far. We assume that these costs are inherently present in any institutional arrangements and as such are determined (1) by the institutional design and (2) subsequently by the behavior of the various actors. In this rather conceptual paper we come up with a definition and a description of governance costs in regulatory arrangements.

The analysis of institutions and the part they play in the governance of economic action is the central challenge addressed by new institutional economics (NIE). The theoretical framework of new institutional economics links different approaches to explain economic activities and economic behavior. It builds on, modifies, and extends neoclassical theory. One particular approach for such a definition is the transaction cost approach: following Williamson (1998), transaction costs vary in their attributes, as well as governance structures vary in their costs and the alignment of competences within a regulatory regime. Therefore we formulate two questions which we would like to answer in this paper:

- Which criteria are useful to assess regulatory governance costs in corresponding institutional arrangements?
- What are the costs of regulatory governance in network industries?

In many regulated industries it is apparent from even simple empirical observations that sector specific regulators are not neutral actors promoting market perfection in a disinterested way. In our article we are focusing in particular on the role of the regulators and their relationships (among regulators, operators and to their principals in the federal administration and the government). Considering our proposition – regulatory agencies are self interested actors and their behavior affect governance costs – we argue that the definition of governance costs should go beyond existing theories, such as transaction costs and agency theory, and should involve aspects of organizational behavior.

The first contribution of our paper is to come up with a clear definition of regulatory governance costs. The second contribution is the description of criteria to assess regulatory governance costs and their drivers in regulatory

regimes and provide evidence in the postal sector. After the short introduction we outline our framework of regulatory governance costs and its relation to the New Institutional Economics. In section 3 we give a brief overview on regulatory governance structures in postal markets within the European context, and investigate if our framework is applicable in the postal sector. We end up with a conclusion and an outlook on our future research in section 4.

2. TOWARDS A DEFINITION OF REGULATORY GOVERNANCE COSTS

Even though there is a strong trend toward independent sector specific regulatory authorities across sectors and countries, liberalization has not led to a general European regulatory model. Coen (2003) stresses the fact, that liberalization in EU telecom industry has not lead to a uniform regulatory regime. Similar observations apply to other network industries and in the transforming postal sector. Different countries exhibit different institutional regimes (in network industries in general and in the postal sector in particular), which in turn lead to different regulatory practices. The creation of new independent and sector-specific regulatory agencies gives rise to a potentially important agency problem: Regulators may well tend to act in their own interests and contrary to the intentions with which they were originally established.

One might ask “Why do define and use regulatory governance costs as a means to analyze regulatory governance regimes?” With our definition of regulatory governance costs we try to set up a comparative approach to compare regulatory institutions in different regimes by means of the main concepts of new institutional economics. Concerning comparative approaches in the analysis of institutions Aoki (2001) states: “Institutional arrangements can be diverse across economies even if they are exposed to the same technological knowledge and are linked to the same technological knowledge and are linked through the same markets. Thus we need to rely on comparative and historical information to understand why particular institutional arrangements have evolved in one economy but not in others” (p.3). Therefore we would like to take the concept as a tool to gain insights on how particular institutional regimes work and what the roles of institutional actors are and finally to learn what its strengths and weaknesses are.

Following this, the chapter is concerned with proposing a framework, by which regulatory regimes can be assessed in a uniform way adapted from New

Institutional Economics and Organizational Behavior Theory. Before this is done, it is beneficial to briefly discuss the definition of regulatory governance.

2.1 Definition: Regulatory Governance

In their article on “Governance as a bridge between disciplines” van Keersbergen and van Waarden (2004, p.146) state, that classical economics assumes markets to be spontaneous social orders which work best in the absence of intervention, while new institutional economics, economic sociology and comparative political economy start from the opposite assumption¹: These theories emphasize that markets are not spontaneous social orders, but need to be created and maintained by institutions. Institutions are the instruments to monitor and enforce rules of the game, to ensure property rights and contracts as well as to reduce information asymmetries, risk and uncertainties.

Ruiter (1999, p.287) describes Governance as a wide and ambiguous term. But with respect to the public sphere it refers to something like institutional arrangements serving public interests. He further compares government approaches and governance approaches: Governance approaches rely on the assumption that even though it may be the case that some objectives are rather realizable by direct government action, various other public objectives can be efficiently realized through the agency of individuals or private organizations pursuing their own interests (Ruiter, 1999, p.287). In their seminal article on institutional foundations of regulatory commitment, Levy and Spiller (1994) emphasize that there are multiple regulatory regimes which are consistent with good performance. They define regulatory governance from an institutional perspective as “the mechanisms that societies use to constrain regulatory discretion and to resolve conflicts that arise in relation to these constraints.” Dassler (2006) defines regulatory governance more accurate as the “way the regulatory office acts under the aegis of the government, in the form of legislative acts and other forms by which control can be maintained over the regulated sector” (p.33).

Majone (1996, p.2) discusses traditional forms of regulation and control (regulatory governance structures) in Europe including public ownership, the assignment of regulatory functions to departments of governments under direct control of political executives, and various self-regulatory arrangements. These

¹ See Williamson (1985, 1996) for New Institutional Economics; Smelser and Swedberg (1994) for Economic Sociology; Hollingswoth and Boyer (1997) and Hall (1999) for comparative political economy.

modes of regulation are gradually displaced because regulatory policies are nowadays rarely implemented by politicians themselves. Governments delegate regulatory competencies to specialized authorities. Independent sector-specific regulatory authorities are a relatively recent phenomenon and in just a decade they have become widespread in Europe (Braun/Gilardi 2006, S.10).

The implementation of regulatory regimes or systems involves a number of tasks to be performed. Bauer (2005, p.55) defines administrative burdens in a regulatory context as factors to (1) sustain competitive but fair markets, (2) set incentives for involved actors to provide a certain level of public service, judged politically desirable and (3) coordinate public authorities related to (1) and (2). In his article on regulatory institutions Ogus (2002, p. 638) examines different parts of regulatory processes. As a part of the policy-making procedure, the goals of the regime must be established and transformed into the principles and rules which control behavior. Furthermore there must be reliable procedures for explicating and enforcing those principles and rules as well as for the adjudication of disputes arising from them. Important structural decisions concern the determination of how these tasks are allocated to different institutions and actors. Ogus (2002) states that this allocation has a vertical (the degree of control over these institutional actors) as well as a horizontal (the extents to which authority should be conferred to institutional actors other than the legislature or executive) dimension.

According to Minouge (2002) and Ogus (2002) a proper regulatory governance system specifies:

- what the institutions of rule-making are,
- who are the rule makers,
- how and by whom are the rules implemented and
- what forms do compliance and accountability of the actors take.

2.2 New Institutional Economics and Regulation

A question to ask is what governance costs are made of. Willman et al. (2003, p.73) criticize the purely economic approach to regulation: the economic approach to the design of institutions tends to focus on outcome, rather than the analysis of the process. Therefore it does not adopt a dynamic perspective on institutional change. It is prescriptive rather than analytical, and it focuses on the properties of institutions rather than taking the regulatory relationship as a unit

of analysis. Finally, it considers the firm as a single decision point which seeks return on investments whereas the analysis of regulatory activity within an organization is neglected.

Concerning the theory of regulatory economics, Laffont and Tirole (1993) criticize the fact that economic theory ignores incentive issues to a large extent, and the theory does not consider the standards of the newly developed principal-agent theory. They further argue that the simplified economic models, which ignored the presence of imperfect information, were unrealistic because they implied policy recommendations that require information which is not available to regulatory authorities in practice. Laffont and Tirole (2000) abandon the standard economic assumption which defines regulators as well-informed and benevolent actors whose mission is to perfect an imperfect market and to achieve the best results for society. They argue that regulators, like other economic actors, are self-interested: "They, like anybody, must be provided with incentives to become (economic and technological) experts, to think hard about specific regulatory issues and to shun putting their career concerns or the stakes of their favored interest groups or causes first (p.274)".

The development of the major branches of new institutional economics took place with the ambition to apply more institutional realism to neoclassical economics. The overall aim of this extension is to better explain and predict the behavior of utility maximizing individuals and profit maximizing firms in market relationships. We assume that the implications of new institutional economics on regulation theory and practice are enormous, though still largely unexplored. Thus the question arises, if the elements of new institutional economics are applicable to regulated network industries or the public sector.

At the most general level we answer the question, and say that new institutional economics reaches the conclusion that regulation has a cost, which can be of course minimized, but which nevertheless will be unevenly distributed among the actors of the broader institutional framework. According to new institutional economics, these costs will depend upon the formal and informal rules among the involved actors, upon the allocation of property rights among these actors, as well as upon the various principal-agent or more generally contractual relationships among these actors. As these costs are not easy to quantify, we raise the questions "How can we concretize the definition of the costs of regulatory governance? And is this connectable to the main branches of new institutional economics? "

2.2.1 Regulatory Governance and the Transaction Cost Approach

Dollery (2001) explains that bounded rationality unambiguously implies that complexities of actual economic exchange cannot be fully captured by hierarchical contracts or market mechanisms. Since bounded rationality prevents the construction of complete contracts between agents and principals, scope exists for opportunistic behavior by economic agents, who can hide their preferences and actions from contractual partners (Williamson, 1975). Indeed, it is precisely because of real-world phenomena, like bounded rationality and incomplete contracts, that economic activities have to be conducted in an environment characterized by asymmetric information and costly transactions, and it is these features which lend crucial importance to institutions and in the case of regulated industries to regulatory institutions respectively regulatory frameworks.

Arrow (1969) defines transaction costs as the “costs of running the economic system” (p.48). Through the lens of transaction cost economics as well as agency theory, different modes of regulation can be described as alternative modes of governance which are well suited for some objectives but purely suited for others. The transaction cost approach interprets governance as organizing transactions in order to economize on transactions. Williamson (1998) sketches in brief the transaction cost economic perspective on the public bureau. He describes the public bureau as an alternative mode of governance which is well-suited for some purpose but poorly suited for others. Williamson (1998) summarizes that “there is no one, all-purpose, superior form of organization. Transactions vary in their attributes; governance structures vary in their costs and competencies, efficient alignment is where the predictive action resides. The unchanging lesson of transaction cost for all feasible forms of organization, of which the public bureau is one, is this: a place needs to be made for each generic form, but each generic form needs to be kept in its place.(p.46)”

In the article “Public and private Bureaucracies: A Transaction Cost Economics Perspective” Williamson (1999) then characterizes three different forms of public governance: (1) full privatization, (2) regulation, and (3) the public agency which are briefly described below:

(1) *Full Privatization* is described as a relational contract which establishes an enduring exchange between firms and the state that regulates transactions related to goods or services the firms supply.

(2) *Regulation* denotes a complex governance structure including long-term contractual exchange regime between a firm and the state which regulates transactions concerning the goods and services the firm supplies, an enduring authority regime between the state and an organ which regulates the supervision of the firm, and an enduring supervision regime between the authority and the firm that is based on a relational contract between the firm and the state.

(3) The *public agency* relies on an enduring authority regime between the state and an organ which regulates the organ's provision of goods and services to which the state is authorized.

Furubotn and Richter (1992) describe the transaction cost approach as "most easily understood as embracing all those costs that are connected with (i) the creation or change of an institution or organization and (ii) the use of the institution and organization (p.8)". To summarize: to establish and to maintain institutions results in costs. Epstein and O'Halloran (1999) describe transaction costs economics as an approach for comparative institutional analysis where a given set of transactions may be characterized by its variety of costs; and different modes of governance might affect the level of these costs. In their perspective the task of the transaction cost approach is to predict how optimal governance structures change as the formation of transaction costs changes. We suggest that these two ways of looking at transaction costs are the most likely approaches to apply to regulatory governance.

Estache and Martimort (1999) identify two types of transaction costs related to regulatory institutions. The first type of transaction costs is dependent on the degree of informational problems faced by the government and on the limitations in governments' scope have in relying on the market to implement its regulatory responsibilities. The second type of transactions costs is related to the difficulties in establishing fully contingent contracts. Because this sort of contracts often cover a limited period of time, hence not compulsory for future generations or governments, which leads often to renegotiations of administrative and incentive costs.

2.2.2 Regulatory Governance and Agency Theory

Jensen and Meckling (1976) applied in their seminal contribution the agency theory exclusively to the firm. But they mention the generality of the theory already in this early initial stage of the theory: "The problem of introducing an

agent to behave as he (or she) were maximizing the 'principal's' welfare is quite general. It exists in all organizations and in all co-operative efforts – at every level of management in firms, in universities, in mutual companies, in co-operatives, in governmental authorities and bureaus, in unions and in relationships normally classified as agency relationships such as are common in the performing arts and the market for real estate''(p.309).

Gilardi (2001, p.2) states that principal-agent models have considerably been used by American political scientists for more than twenty years, but that their application to the European system of regulation is much more recent. The debate in the European context has been launched in a special issue of the *European Journal of Political Research* (37/3, 2000), where parliamentary systems have been analysed as a chain of delegation. The major steps of delegation have been considered from a principal-agent perspective: delegation from citizens to their representatives in parliament, from the parliament to the government, from the government as a whole to single ministers, and finally from the government to the bureaucracy. The step of delegation from the government to independent regulatory agencies is not considered in this discussion.

The governmental actors respectively the political principals create the agencies and define their legal shape, formal objectives and decision-making procedures, appoint the key personnel and later monitor the agencies' activities. According to Majone (1999) and Horn (1995) agency theory suggests that the following variables are critical when political principals structure the relationships (to the independent regulator) in a manner that the outcomes of the agent's efforts comply with democratic accountability (Majone, 1999, p.13-14):

1. The extent to which decisions are delegated to an independent agent rather than taken by the principle himself, with the choice ranging from 'no delegation' to 'full delegation'.
2. The governance structure which includes both organizational form - single headed agency, multi-headed commission, self- regulatory organization, and so on – and methods of appointment of key personnel. The nature of the governance structure to a large extend determines the agency's degree of independence from the political process.
3. The rules that specify the procedures to be followed in agency decision-making. Examples are reason-giving requirements, and rules defining the right of various groups to participate directly in the decision-making process.

4. The procedures to be followed when principals wish to overrule agency decisions.
5. The allocation of resources in particular the agents' employment conditions, and the extent to which the agency is financed by government or by the sale of its services.
6. The extent of ex-post monitoring through ongoing legislatives and executive oversight, the budgetary process, judicial review, citizens complaints and peer review.

Following and summarizing Majone (1999, p.7) the key findings of agency theory for regulatory governance is that the control of agents is to a large extent a question of good institutional design.

We assume that the implications of transaction costs and agency theory on regulation theory and practice are particularly relevant, but remain - save for a few exceptions mentioned in the literature review above - widely unexplored.

2.3 The Role of the Regulator – A driver of Governance costs?

Wilks and Bartle (2002) argue that the original decision of governments to delegate and the design of agencies were primarily motivated by a need to reassure and to appear to act. The agencies were not expected to be extremely active in developing and implementing policies. However, the regulatory agencies have become more active than expected and have contributed to policies (p.148). Wilks and Bartle further state that "the consequences of creating agencies has been to populate the policy area with actors (agents) who have their own priorities, interpretations and influence (p. 148)". Spiller and Tommasi (2005) emphasize a shift away from investigating regulation as a pure government/firm game. The agency is by definition created as an entity to be independent from governmental, and consequently from political, influence. Spiller (1990) points out that regulators do not fully respond to governmental desires and raises the question: "Why does Congress delegate regulatory issues to agencies that are not fully aligned with it and what are the implications of delegation for regulatory commitment?" (Spiller/Tommasi 2005, p. 531).

An explanation of the phenomenon of delegation is given by Majone (2001) as well as Thatcher and Stone Sweet (2003): Following their comments, the aim of delegating regulatory issues to agencies is to establish market and technical expertise, blame-shifting potential, and credible commitment to efficient market

developments. However, creating an independent regulatory agency gives rise to a potentially important problem: agencies may act in their own interests and contrary to the objectives and policies established for the original political intent (McCubbens, Noll, Weingast, 1989, p. 246).

Concerning the control of regulatory agencies Weingast and Moran (1983) develop the “Congressional Dominance” hypothesis which implies that independent agencies are not fully independent. The circumstance that agencies underlie permanent congressional oversight raises potential agency problems. Perfect oversight would require congressional instruments to be powerful enough to fully control the regulatory agency. Agency problems between government and regulatory agencies occur because regulators’ actions are intrinsically unobservable. Gilardi (2005) states that governments usually lack control mechanisms which enable them to have an effective and direct impact on the regulatory agency’s behavior. Hence the specialized independent and sector-specific agencies are, unlike ordinary bureaucracy, difficult to control.

Bonardi et al. (2006) state that agency decisions can have important consequences for stakeholders (especially firms) and that agencies behave differently from elected political institutions. Regulators are generally appointed rather than elected. Therefore they do not face the election constraints that typically motivate elected politicians’ behavior. Prior research highlights, that regulatory agencies’ objective functions are multidimensional: regulators tend to maximize their budgets, enlarge the number of employees or enhance career prospects and political reputations (Mueller 2003; Wheaterby 1971). Majone (1996) summarizes that the achievement of such objectives depends on the legitimacy that the regulator holds within the institutional framework. He defines the preservation and the enhancement of legitimacy as a meta-objective of regulators.

2.4 Regulatory Governance Costs

Costs of regulatory governance are related to tasks and transactions in regulatory regimes concerning bargaining and decision-making processes in policy making and policy enforcement, the control of institutional actors and the industry and the search and supply of information. We define regulatory governance costs as the *costs of establishing, maintaining and coordinating a regulatory arrangement*. In line with Bauer (2005) and his definition of administrative burdens we describe governance costs in a regulatory context as the costs related to tasks performed to sustain competitive but fair markets, set incentives for involved actors to provide a certain level of public service, and to coordinate public authorities

involved in regulation. In the following section we define the different categories of governance costs which we think are useful for the analysis of regulatory institutions and regulatory governance systems: monitoring costs, compliance costs, coordination costs and costs of regulatory failure. We try to line out what these governance costs are made of and formulate a related set of questions after the definition of each category. The answers on these questions should help to analyze the shape or value of governance costs in a particular case study by using the framework of regulatory governance costs.

2.4.1 Monitoring Costs

The transfer of policy-making/advice powers from political principals like legislators and government executives to bureaucratic agents like the designated regulatory agency implies costs. Monitoring *costs arise because the agents do not implicitly share the objectives of the principals.*

- Drivers and components

Regulators may well tend to act in their own interests and contrary to the intentions with which they were originally established, and their activities have to be monitored. In such a dynamic context where regulatory authorities behave as self-interested social actors², regulators start to strategize vis-à-vis the other actors so as to increase their own discretionary power and become part of economic interaction they were supposed to govern. The relationships among the different governmental layers and the regulated firm can be isolated as a Principal-Agent relation with its own informational problems. This implies that different actors face different types of monitoring problems. The government or the responsible ministry may have problems to control the regulators because they have in general an informational advantage because of their expertise in the regulated industry or because they have access to information which is not attainable for the governmental actors. It is fairly obvious that regulators (sector specific or competition agencies) face informational asymmetries in their relationships with the firms they regulate. There might be a lack of knowledge about the exact technologies the firms use or what the elasticity of the demand in the sector is. They further do not know what the internal incentive structures of

² Actors react differently to external threats, constraints and opportunities because they differ in their intrinsic perceptions and preferences but also because these are shaped by the specific institutional setting within which they interact (Scharpf 1997, p. 37). Crozier (1964) interprets such a behavior as “the active tendency of human agent to take advantage, in any circumstances, of all available means to further his own privileges” (p.194).

the firms are or what contract they have with other suppliers (Estache and Martimort, 1999).

Another type of monitoring costs for regulators are all kind of costs related to the gathering of information like salaries, consultancy fees, and others more. Similar costs can also be identified for the competition regulator.

Related questions to investigate monitoring costs in a certain regime:

- What are the responsibilities of the regulator?
- What is the annual Budget of the Regulator/ Government Entity?
- Staff size?
- What is the legal personality/ form of the regulator?
- By which means does the regulator enforce decisions?
- How is the Staff composed?
- What is the internal organization of the regulator?
- To whom are regulators accountable?

2.4.2 Compliance Costs

Compliance costs are the costs of the industry to comply with regulation. Since the historical operator is generally more heavily regulated than its competitors (through asymmetric regulation), it is likely that the historical operator bears the largest portion of the compliance and the bonding costs.

- Drivers and components:

Compliance costs result from the fact that the operators have to comply with regulatory directives, and moreover have to be in good terms with the regulator (e.g. bonding costs). Costs of compliance do not only arise in compliance departments or departments of regulatory affairs. In most cases these costs are spread over all departments or business units. The drivers of these costs include costs like labor costs, costs of administrative overheads, legal expenses and consultancy fees as well as costs that occur in order to adjust to new regulatory requirements.

Regarding monitoring and compliance costs Coen (2005, p. 377) states that there emerges something like a resource dependency between regulators and regulates. In order to achieve his mandate, the regulator tries to establish detailed information supplies on the market and credibility with the business they regulate. In the same time the regulated business wishes to understand the

regulatory process and principle and where possible to exert influence on the development of regulatory institutions and the regime.

Related questions to investigate compliance costs in a certain regime:

- How is the information exchange organized?
- What are the reporting requirements to the regulator(s)/ the government?
- How many operators are active in the sector?
- What are the formal relationships between the regulator and the regulated?
- Are there informal relationships?
- Who designs and controls the regulator's objectives?
- Is there an arbitration process in case of disagreement?

2.4.3 Coordination Costs

We call costs which are related to coordination within the regime *coordination costs*; this third construct of governance costs underlies the assumption that there is more than a single institutional actor involved in regulated industries. Apart from a sector specific regulatory agency a ministry of the regulator or the sector and a competition regulator play important roles in regulatory regimes. Böllhoff (2005, p. 16) describes a political administrative context, where regulatory regimes even include more than these three institutions: besides the sector related ministries, departments like the treasury can be involved in regulatory processes. Administrative courts may also play a crucial role in decision-making processes. Furthermore, parliamentary actors and committees have an impact on regulatory regimes, too.

- Drivers and components:

In line with Bauer (2005, p.56) we suggest, that the more dispersed the regulatory regime becomes (ministries, regulators, competition authorities) the more likely are administrative infights over power and competences. Furthermore, based on theories of bureaucratic politics and organizational behavior, we assume that the involved public authorities try to seek to enhance or at least to stabilize, their own role in the regulatory system (Bauer, 2005, p.56).

We mentioned above, that regulators were not expected to be very active in developing regulatory policies but they become more and more active in this field. The alignment of these activities with the actors involved in legislation is somehow costly, too.

Stemming from the fact that different regulators and actors – like e.g. the sector specific regulatory agency and the traditional competition regulator mentioned above – are intervening into a sector and therefore need to be coordinated. If coordination is not optimal, there are probably many additional costs resulting from the duplication and inconstancies of the activities. A further source of governance costs which are related to coordination are the various additional costs stemming from court cases and different types of watchdogs.

Related questions to investigate coordination costs in a certain regime:

- Who designs the institutions within the sector?
- How many regulators are involved with the sector?
- How many Ministries/ Governmental Agents are involved with the sector?
- How much independence is the agency given?
- To whom are regulators accountable?
- Who makes decisions within the regulator? The regulatory system?
- How is the information exchange organized?

2.4.4 Costs of regulatory failure

The fourth category of regulatory governance costs are the *costs of regulatory failure*. The costs of failure occur when regulation generates more economic costs than benefits. Regarding regulatory governance and compared to the other three categories this type of cost has a rather indirect character because it is more related to the specific tools implemented to regulate the markets than to the institutional governance regimes and the institutional actors.

- Drivers and Components

The original rationale of governments to intervene in network industries and to introduce regulation has been a market failure – usually due to monopoly or oligopoly power. The economic assumption was that without regulatory intervention, prices will be too high, restricting demand and creating excess profits; all of these create inefficiencies and lead to high social costs and loss of welfare. But it may come about that policy makers and/or regulators use wrong or imperfect models to guide their decisions, with a major impact on the investment incentives of firms, a misallocation of resources and a lowering of social welfare. The indirect negative effects of regulatory governance may result from a distorted static and dynamic allocation through improper pricing, technology choice and innovation incentives. The characteristics of these issues are often a result of regulatory governance respectively regulatory decisions.

The overall assumption of costs of regulatory failure is that while the objective of regulatory intervention is to improve market functioning, actions of regulators can have unintended negative outcomes as well. These outcomes may have effects on the nature of the market and the availability of products provided in the market, consumer choice, the level of innovation or even discourages firms from entering into markets.

A particular driver of regulatory failure is the fact that if some regulatory mechanisms work adequately in a particular sector or country does not mean that they would be adequate in other industries without adaptation. The choice of adequate or optimal regulatory tools and mechanisms is often related to specific characteristics and market structure in a particular industry.

Related questions to investigate costs of regulatory failure in a certain regime:

- What kind of tools are implemented to regulate the market (pricing rules, access regimes)?
- How did product prices evolve in recent years?
- Are there minimum wages defined?
- How many operators are active in a market?
- Are there significant (radical) innovations?

2.5 Theoretical Summary: Categories of Regulatory Governance Costs

In section 2.4 we identify four categories of regulatory governance costs. Table 1 summarizes the different categories, the key assumption, its drivers and the components. We argue that these overall costs of regulatory governance are still largely underestimated or even ignored. In contrast to types of costs we know (e.g. operating costs) the costs of regulatory governance are often difficult to quantify and may have to be analyzed on a qualitative basis.

So far we are able to identify two different dimensions that contribute to the construct of governance costs: the first dimension is rather institutional and is related to the formal rules and the institutional structure of the regulated sector. Concerning the regulators it includes issues like the formal competences and the objectives of regulatory policy. The second perspective is much more actor-centered and implies that governance costs are affected by informal rules and the strategic behavior of regulators which have their own objectives and political attitudes.

Table 1: Summary – Four Categories of Governance Costs

Category	Key Assumption	Drivers	Components/ Indicators
Monitoring Costs	<i>Agents/Actors do not implicitly share the objectives of their principals and need to be monitored</i>	<ul style="list-style-type: none"> • Agents behavior • Information Asymmetries • Accountability of Agents 	<ul style="list-style-type: none"> • Annual Budgets of Agents • Salaries and consultancy fees • Staff size • Number of active operators in public services
Compliance Costs	<i>Operators face costs when they comply with regulatory directives</i>	<ul style="list-style-type: none"> • Operators behavior/ Strategy • Relationships (formal/informal) • Modalities of information exchange • Distribution of Power 	<ul style="list-style-type: none"> • Labor costs related to compliance activities • Administrative overhead • Adjustment to regulatory changes • Consultancy fees
Coordination Costs	<i>There is more than one single actor involved in regulatory processes and their activities have to be coordinated</i>	<ul style="list-style-type: none"> • Institutional design • Institutional Powers (Who defines rules?) • Alignment of regulators • Regulatory processes 	<ul style="list-style-type: none"> • Number of institutional actors involved in regulatory processes • Degree of independence of the regulator • Accountability of regulators
Costs of regulatory failure	<i>Actions of regulators (or policy makers) can have negative effects on the regulated industries and the consumers</i>	<ul style="list-style-type: none"> • Sector specific characteristics • Regulators knowledge about the industries • Regulators strategy • Regulators economic knowledge/ expertise 	<ul style="list-style-type: none"> • Regulatory tools to improve competition and sustainability of public services. • Evolution of product prices • Degree of innovation in an industry

3. REGULATORY GOVERNANCE STRUCTURES IN THE POSTAL SECTOR

The postal sector is a particularly interesting sector because it is a major industry in terms of sales and employment. A second aspect is that there has been considerable involvement of governments because most postal services are or were state owned monopolies. Liberalization in the postal sector (and in the other network industries) is accompanied by new institutional arrangements with new actors, notably sector-specific regulators. As mentioned above there is

a strong trend toward independent sector-specific regulatory authorities across sectors and countries, but liberalization has not led yet to a unified European regulatory model. Most of the new institutional arrangements do indeed have at their core an independent sector specific regulator, but there are still significant differences among countries. In the following we discuss briefly the regulatory governance system in Europe. The aim of the following section is not to fully apply the governance cost framework on the European postal sector. It is more likely to show the variety in implementing regulatory frameworks which implies that differences in monitoring, compliance and coordination exist within the postal sector.³

3.1 Postal Regulation on the European Level

The main areas that are regulated or supervised by regulatory authorities in the postal sector are the universal service, the scope of the monopoly (reserved area), the quality of services, access to established postal networks, licensing and authorization and certainly prices of the universal service and in the reserved area. The provision of postal universal services has played a key role in shaping the European directives which aims to safeguard postal services as a universal service in the long run and to increase competition simultaneously. Concerning this universal service, the European directive 2008/6/EC provides that “member states shall ensure that users enjoy the right to a universal service involving the permanent provision of postal service of specified quality at all points in their territory affordable prices for all users.” Furthermore the directive describes the minimum requirements of the Universal Services which includes clearance and delivery (minimum 5 days per week), the scope of products in the universal service (clearing, sorting, transport and distribution of postal items/ parcels up to 2/10 kilograms and. Regarding the price regulation, the directive’s most important specifications concern the affordability as well as the claim that prices should be cost-oriented and non-discriminatory. Quality standards are mainly focusing on routing times and on regularity on reliability of services. With respect to the reserved areas the adoption of the Directive 2008/6/EC implies that full market opening of the postal markets has in general to be provided until 31 December 2010 (with a few exceptions which are allowed to postpone until 31 December 2012). In the year 2008 four European countries are fully liberalized (Germany, UK, Sweden and Finland).

Member States have a certain degree of freedom in transposing the European directive into national legislation and the regulatory system. It will be interesting

³ The application of the regulatory governance costs framework will be part of our future research.

to analyze the similarities and differences among countries in regulatory practices.

3.2 National Regulation

So far, all European member states have some sort of regulatory authority which appears to be formally independent from postal operators, but in some cases the incumbent postal operator and the regulatory authority are still under control of a ministry. Ecorys (2008) notices that “both the regulatory frameworks and the mandate of the and resources of the regulatory authorities differ considerably from country to country, making it difficult to identify best practices....The developments in the regulatory (legal) framework have not always be driven by the regulatory authority in isolation, and may involve legal changes instigated by the state, and competition authorities.(p.87)”

This observation becomes clearly evident even if a handful of regulatory bodies are compared. The four countries (UK, Belgium, Netherlands, and Switzerland) sketched below show how regulatory frameworks differ in their institutional arrangement and in the shape of the involved regulatory authorities:

- *Belgium*: The Belgium IBPT (Institute Belge des Services Postaux et des Telecommunications) was the first independent regulatory agency in the postal sector in Europe. It was set up in 1991 and its status was revised in 2003, in order to ensure its independence. The agency (218 employees) is responsible for the telecom sector as wells as for postal operations (9 employees). The reserved area contains standard letters and direct mail up to 50g since 2006. The responsible ministry for the postal sector is the ministry for economic affairs and a second involved regulatory authority is the competition regulator.
- *United Kingdom*: The British Postcomm was set up in 2000 and it is a large and very powerful regulatory body (60-70 employees) with a relatively large budget (10 Million £). It is responsible for the postal sector only and unlike other countries, Postcomm is funded by the operators and not by the government. The market is fully liberalized since January 2006. Other authorities with effect on the postal markets are the office for trading, the competition commission and the department for Business, Enterprise and Regulatory Reform.

- *Netherlands*: The OPTA (Independent Postal and Telecoms Authority) is a small postal regulation office (6-8 employees) within a cross-sectoral authority (120 employees). It was set up in 1997 and is responsible for Telecom, broadband & broadcast, postal and consumer affairs. It is funded by the ministry of economic affairs. The reserved area includes items up to 50 gram. A specific feature of the Dutch regulatory arrangement is that the regulatory authority has no power to demand date of the incumbent operator. Other authorities in touch with the postal sector are the Ministry of economic affairs (price regulation) and the competition authority.
- *Switzerland*: The sector specific regulator PostReg (10 employees) was set up in 2004. It is so far not absolutely independent from the government and organizationally attached to and funded by the Department of Environment, Transport Energy and communication. Other involved regulatory authorities are the competition commission, and the so called price regulator. The reserved area in Switzerland contains addressed domestic letters up to 100 gram. (See the detailed case study in appendix 1). Switzerland is not member of the EU and follows a policy of autonomous adaption to European legislation.

The examples given above underline, that all EU member countries and Switzerland implemented a regulatory authority. But the governance structures differ from country to country. The regulatory systems do not only differ in the way they are institutionally organized but also in the issues that are regulated and how they are regulated. WIKConsult (2005, p. 86) recognizes that regulatory policies vary in the scope of

- the services regulated,
- methods that are used for price regulation,
- competent authorities of price regulation,

as well as in the concepts used to implement the European directive with respect to

- affordability of services
- cost-based tariffs and
- uniform tariffs.

In this context Ecorys (2008) observes concerning price regulation that 27 countries establish some form of price control in the universal service, but the definition of the universal service vary by state. Regarding the differences in the

regulatory environments, the three categories of governance costs seems to be an appropriate way to compare the different regulatory governance regimes. Answering the set of questions provided in section 2.4, should help to learn more about the institutional design of regulatory governance structures and the actors involved in regulatory tasks.

4. CONCLUSION

In the present article we define regulatory governance costs as the *costs of establishing, maintaining and coordinating a regulatory arrangement* and come up with four categories of regulatory governance costs:

- Monitoring costs arise because of informational asymmetries in their relationships of principals with their agents.
- Compliance costs are the costs the industry face in order to comply with regulatory requirements.
- Coordination costs result from multiple institutional actors involved in regulated industries, and that the different actors have to be coordinated.
- Costs of regulatory failure occur when actions of regulators have (often unintended) negative effects on the regulated industry.

Concerning the analysis of regulatory governance structures and institutions we come to the conclusion that monitoring costs and predominantly coordination costs are of a higher importance than compliance costs when it comes to an assessment of regulatory governance structures and institutions. Compliance costs are rather related to how the monitored operator or industry deals with his obligations than to the institutional environment. How the regulators enforce their need of data from the operator and which instruments they use is rather a question of the institutional background and the governance structures.

In section 2.2 we give an overview on the main branches of New Institutional Economics which we think are useful to apply on regulatory governance structures. Even if we come up with a proper definition of governance costs we face a major problem when we compare our framework with the transaction cost theory and the principle-agent approach: We are not able to fully assimilate the theories in our framework on governance costs. However, we argue that the overall costs of regulatory governance are still largely underestimated or even ignored in the analysis of institutional frameworks and there is space to expand the new institutional economics in a way that allows the comparison of

regulatory frameworks. In the present article we draw a blueprint of what regulatory governance costs are and what they consist of. The challenges of this sort of research and the application of the governance costs approach is how to describe the different regulatory regimes in a way that allows a clear comparability of governance costs. Therefore we will try to define proper proposition linked to regulatory governance structures and the inherent governance cost. So far we are able to identify two different dimensions that contribute to the construct of governance costs: the first dimension is rather institutional and is related to the formal rules and the institutional structure of the regulated sector. Concerning the regulators it includes issues like the formal competences and the objectives of regulatory policy. The second perspective is much more actor-centered and implies that governance costs are affected by informal rules and the strategic behavior of regulators which have their own objectives and political attitudes.

In our future research we would like to apply this theoretical framework to regulatory governance structures in the postal sector. The explanations about the different regulatory governance structures show that there is variety within the different countries and different actors are involved in establishing and maintaining regulatory frameworks as well as in coordinating and monitoring regulatory regimes. A particular case study will be structured along the framework of regulatory governance costs and deal with questions concerning monitoring activities, compliance requirements and institutional coordination within the sector.

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APPENDIX I: DIRECTIVE 2008/6/EC ARTICLE 22

CHAPTER 9

The national regulatory authority

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Article 22

1. Each Member State shall designate one or more national regulatory authorities for the postal sector that are legally separate from and operationally independent of the postal operators. Member States that retain ownership or control of postal service providers shall ensure effective structural separation of the regulatory functions from activities associated with ownership or control.

Member States shall inform the Commission which national regulatory authorities they have designated to carry out the tasks arising from this

Directive. They shall publish the tasks to be undertaken by national regulatory authorities in an easily accessible form, in particular where those tasks are assigned to more than one body. Member States shall ensure, where appropriate, consultation and cooperation between those authorities and national authorities entrusted with the implementation of competition law and consumer protection law on matters of common interest.

2. The national regulatory authorities shall have as a particular task ensuring compliance with the obligations arising from this Directive, in particular by establishing monitoring and regulatory procedures to ensure the provision of the universal service. They may also be charged with ensuring compliance with competition rules in the postal sector.

The national regulatory authorities shall work in close collaboration and shall provide mutual assistance in order to facilitate the application of this Directive within the appropriate existing bodies.

3. Member States shall ensure that effective mechanisms exist at national level under which any user or postal service provider affected by a decision of a national regulatory authority has the right to appeal against the decision to an appeal body which is independent of the parties involved. Pending the outcome of any such appeal, the decision of the national regulatory authority shall stand, unless the appeal body decides otherwise.