

Policy Brief

Tackling the principal-agent problem in international organizations.

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In a nutshell

- **The international organizations suffer from a wide chain of delegation between the principal (the citizens) and the agents.**
- **In this brief, we explain that the principal-agent problem in international organizations arises because of the vested interests of the agents, the information asymmetry between them, and the incentives problems, which results in a conflict between the decisions made by the agents and the principal's preferences.**

Overview of the Principal-agent relationship.

Historically, the term Principal-agent relationship has been introduced by the branch of the new economics of organization to examine the structural relationship inside the firm, the principal-agent model analyzes the challenges that arise from contracting in any setting. Office connections are made when one party (the principal) enters into a legally binding agreement with a second party (the agent) and delegates to the latter some duties for carrying out a function or set of assignments for the principal's sake.

Within the classic representation, the principal is the shareholder of a company that enters into contracts with managers to conduct some tasks. In any case, the principal can be any individual or organization that delegates responsibilities to another one in order to reduce the transaction costs and benefit from the agent's expertise/skills.

In this delegation process, a problem arises between the principal and the agent due to several reasons, **first**: the information asymmetry between them in favor of the agent in which he/she has access to all the internal information which allows the agent to behave in opportunistic behavior and act to serve his own vested interest not the principal's preferences. This conflict of interests will exaggerate in case the agent engages in shirking which is harmful to the principal and hard to be discovered.

Second: the problem of moral hazard in which the agent engages in very risky actions (to gain personal advantages) that the principal would have not conducted if he is in charge.

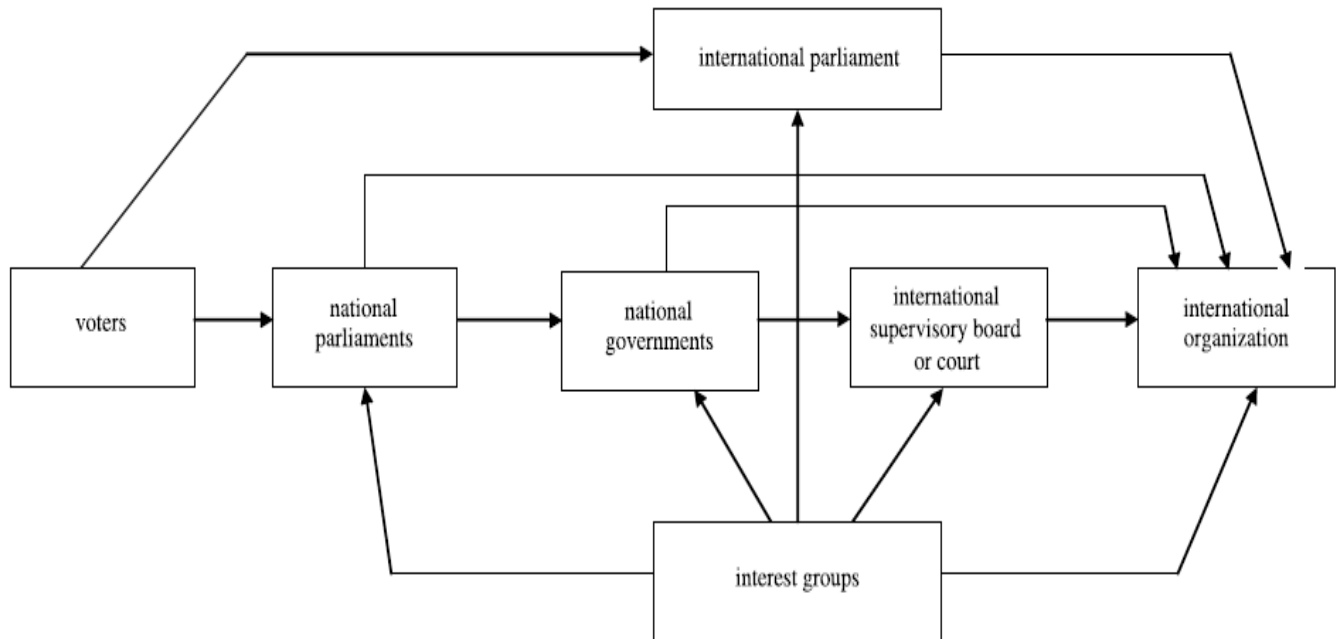
Thus, finding ways to ensure the agent's compliance with the principal's preferences and prevent the agent from behaving contrary to the principal's interest is the responsibility of the principal. These ways could be either by signing a very restrictive contract between the principal and the agent or monitoring all the agent's actions but this solution is very costly for the principal especially if the actions of the agent are hard to be detected.

The international organizations are mainly based on the delegation between the principal (states' citizens) and the agents in these organizations.

The Principal-agent problem in international organizations.

Figure (1), illustrates the chain of the delegation in the international organizations, in which the states' citizens or the voters (the principal) elect the national parliament members, the latter chooses the national government members, then the governments choose the international supervisory board (board of executive directors) which constitutes of representatives who supervise the international organizations. So, the chain from the voters to the international executive involves three agents and four separate principal-agent relationships.

Figure (1)



same period (Vaubel, Dreher, & Soylu, 2005).

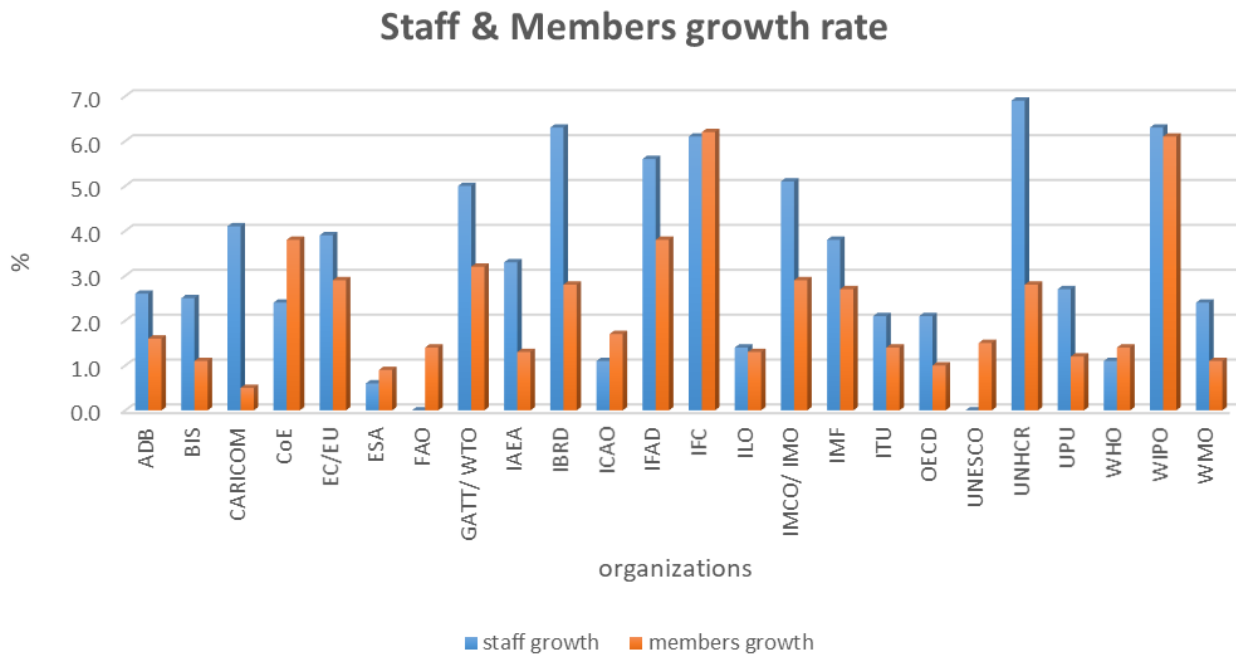
International organizations have been established mainly to serve the interests of the states' citizens (the principal), however, it is considered impossible for every citizen to have a seat in every organization. Thus, there is a need for agents of the principal to be delegated. The agents (as we mentioned above) are supposed to serve the interests of the principal but the problem is in fact, that the agents have vested interests that differ from the preferences of the voters which will lead to inefficiency in the decisions of the international organizations.

The second problem is that the international organizations have more staff annual growth rate than the growth of their state members, reference to a recent study the staff has increased by 3.2% since 1950, in contrast, the members have only grown by 2.5% in the

figure (2), depicts the staff and the member states' growth rate in 24 international organizations within the period 1950-2001. in overall it is obvious that the staff growth rate exceeds the number of members' growth rate hence the elasticity of staff to member states is more than 1.

The objective of every international organization is to obtain more structural growth because this expansion will reinforce its power in the international community, and make it difficult to collapse but more staff will widen the delegation chain between the principal and the agents, cause bureaucratic inefficiency and hence worsen the principal-agent problem.

Figure 2:



Source: graph created using data collected by (Vaubel, Dreher, & Soylu, 2005).

The third problem is the information Asymmetry between the states' citizens and the agents in the international organizations.

Due to the high information cost to the citizens and the lack of incentives to monitor the agents' actions within the organizations, it becomes unattainable for the principal to be informed about the decisions taken behind the doors.

The Principal-agent problem in the literature.

There is a wide debate among scholars regarding the efficiency of international organizations, one of the main challenges

facing them is the principal-agent problem. According to (Vaubel, 2006), the citizens are usually ignorant about the decisions made by the international organizations, due to the centralization of the policies which leads to the impossibility for the citizens to reach the decision-makers inside the international organizations, also pointed out the lack of incentives of the principal to monitor all the agents' decisions due to the high information cost and the very long chain of delegation especially because of the high growth rate of the staff inside the organizations.

Moreover, Vaubel argues that the different agents who are supposed to represent the principal's interests might have different

preferences, and don't have complete capability to influence the decisions inside the organizations. For example, in the European Union, the national parliaments can't ratify the treaties without the approval of the national governments, the high number of parliamentarians might lead to the lack of their incentives to monitor the executives, in addition, they usually follow the same vested policies and interests of their national governments in order to please them.

Furthermore, he added that the governments lack the incentives to supervise the decisions of the international organizations because the latter might help them to be reelected by issuing very optimistic forecasts about the future of their economies before the election, also the international organizations usually work as a scapegoat for unpopular domestic policies, thus the national governments have very distinct preferences and interests from the ones of the citizens.

Reference to Kassim and Menon, (2003), in their research of the principal-agent approach (the EU case), they argue that due to the delegation chain in the EU, a problem of conflicting interests arises and the principal and supranational agents will have different preferences. Thus, the commission will depend on its own resources to implement its own political goals.

Moreover, (Elsig, 2010), has argued that if there is no consensus between the principals on mandates inside the international organizations, then the agency autonomy will be compromised, also he added that if the principals delegate contradicting tasks to the agents, it will negatively impact the

efficiency of the agency performance which will affect the performance of the overall organization.

Furthermore, according to Elsig, in his research on the principal-agent approach in the WTO, he has argued that the autonomy granted to the agents inside the organization can be used in various ways as the agent could stick to the rules, work to fill the gap or exploit their discretion and create buffer zones if the principals act negatively. In addition, he added that usually, the interests of the principals overlap with agents' behavior because of the failure of sharing the ex-ante interests between the principals and the agents.

According to Vaubel, Dreher, and Soylu, 2003, the agency slippage and the bureaucratic efficiency will increase positively along with the rise in the number of the member states in the organization, because as the member states increase, the financial share of every state will decrease till the point approaches zero, so the members (agents) will lose any interest in monitoring the decisions and actions inside the organization due to the little controlling power every state member will have. This lack of incentive to monitor will also include all the agents between the principal and the international organization.

They also concluded that the large countries that share large financial contributions inside the organizations tend to control the decisions made and hence they have the biggest incentives to establish the organizations and keep them going in contrast to the rest of the countries.

Reference to Bradford, Gadinis, and Linos (2008), there is a huge tendency for the international organizations to grow over time, for example, European Coal and Steel Community established in 1952 with only 6 members has evolved to be the EU with 28 members and the WTO has got larger in terms of the number of its member from 23 in GATT in 1947 to almost 162 members. The problem with the large organizations is the greater heterogeneity among the state and also the increase in numbers of agents who represent the principals which will eventually decrease the sharing power of every state and hence its willingness to monitor or control the actions inside the organizations.

Also, they added that a horizontal conflict is likely to happen more in large organizations, especially between the most powerful countries.

Fратиanni and Pattison (2004), in their paper, analyzed the IMF from the perspective of the principal-agent relationship and have concluded that the control power in this organization is vested with a group of shareholders mainly the G-7 governments, this group controls the most monetary resources and have the biggest regulatory control among other members, the group encounters an agency cost problem as the staff and management have a large degree of autonomy because of the high monitoring costs.

Nevertheless, they added that the core shareholders group at IMF tends to control the decisions on big issues.

Policy recommendations:

After presenting the reasons behind why the international organizations – especially the large ones – suffer from the principal-agent problem which affects the efficiency of these organizations thus a set of measures have to be done to ensure the harmonization between the principal and the agents in which their interests match.

For example, control mechanisms have to be applied between the principal and the agents, these mechanisms should be ex-ante through the precise election of the agents, and a precision mandate has to be clearly specified between them.

Furthermore, an oversight committee has to be established by the principals to monitor the most influential decisions of the agents and have the chance of influencing the decision-making process inside the organizations, also an ex-post control mechanism through the periodic reporting issue from the agents regarding the current controversial events in the organizations, in addition, there is a need for a contracting and sanctioning mechanisms to be stated between the principal and the agents to reduce the probability of the agents to act in a conflictual way with the principal's interests.

While autonomy varies, it is also important to assess how agents read their mandates and define their roles. Understanding role reading is central to explaining the different approaches that agents have chosen to use their independence.

Additionally, to tackle the principal-agent problem, the citizens have to be involved in

the choice of whether their country should still be a member of an international organization or exit to reduce the cost of the inefficiency and misrepresentation, such as the choice of the UK citizens to exit the European Union in which this will increase the probability of the principal's preferences to be taken into consideration by the political leadership.

Moreover, the principal has to create an organized interest group especially when the democracy is undermined in the country, by these collective interests groups will act as pressure groups on the government members' decisions inside the international organizations and hence ensure that the interest groups' preferences won't be misrepresented, this policy is considered to be very effective in the EU, in which the farmers, agricultural and textiles workers are forming lobbies to force the European governments to adopt highly protectionist trade policy in these sectors, also the interest groups in the steel industries succeed in forcing the governments to apply measures to protect the industry like the fixed prices, production quota, and subsidies.

Finally, more international efforts have to be exerted to ensure democracy all over the countries, because it guarantees that the elected agents (parliament and government members) share the same interests and preferences of the citizens hence the agents won't have vested interests. And ensure that the principal will be represented efficiently in international organizations.

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