

# Innovating EU Governance Modes: The rise of incorporated transgovernmental networks

By

Burkard Eberlein (York University) and Abraham Newman  
(Georgetown University)

(send comments to [aln24@georgetown.edu](mailto:aln24@georgetown.edu))

European policy-makers have found traditional governance tools such as the regulatory method and intergovernmentalism increasingly frustrating. In response, academics and practitioners began experimenting with voluntary, reflexive governance strategies typified by the Open Method of Coordination (OMC).

While the OMC has received extensive attention in the scholarly literature, a second exit from the current regulatory rigidity has gone relatively unnoticed: incorporated transgovernmental networks. In a range of sectors from financial services to utilities, the institutions of the European Union have directly incorporated organized groups of sub-national actors into the regulatory process. These transgovernmental networks of national regulators take on critical roles in defining and enforcing European rules. The paper situates incorporated transgovernmental networks within the EU governance literature, explores this emerging strategy across a range of sectors, provides two case-studies of ‘incorporated transgovernmentalism’, and then concludes with implications for questions of efficiency, legitimacy, and power within European affairs.

## **The Regulatory Dilemma and New Modes of Governance**

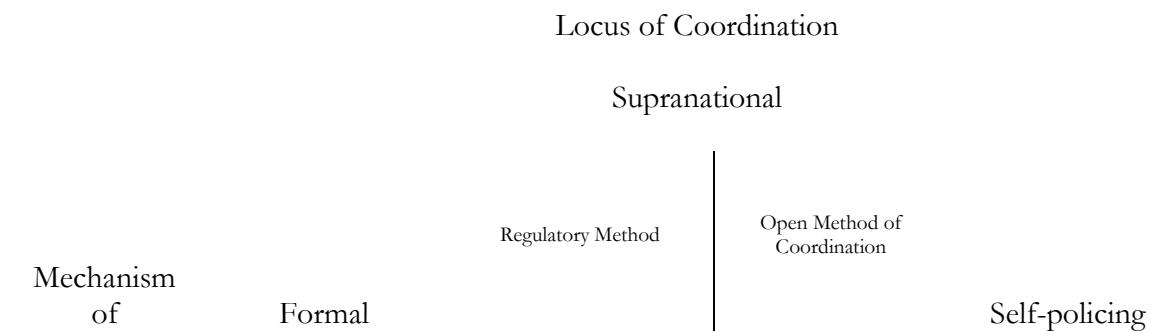
The EU as a system of governance faces the double challenge of effectiveness and legitimacy (Scharpf 1999). In the complex policy environment of a larger and more diverse European Union the effectiveness of the classical blueprint, uniform Community legislation, is increasingly being called into question. Also, the legitimacy reservoir for further delegation of regulatory powers to the EU is rapidly depleting. The resounding rejection of the draft European Constitution by the Dutch and French electorate has underscored the thin legitimacy of ‘an ever closer union’. Yet, short of accepting the negative externalities arising

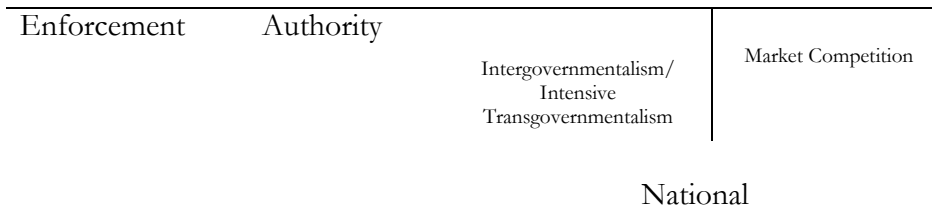
from diverging national approaches, the need for European coordination has increased rather than diminished.

In response to this dilemma, research on the ‘new modes of governance’ has exploded (e.g. Borrás and Greve 2004; Eberlein and Kerwer 2004; Héritier 2003; Radaelli 2003; Scott and Trubek 2002). Departing from the ‘old’ Community method of binding legislation through directives and regulations and relying instead on non-hierarchical coordination of member state policies, new modes of governance offer a potential escape to either the legitimacy or coordination demands. The ‘Open Method of Co-ordination’ (OMC) in particular has received extraordinary attention since the 2000 Lisbon European Council codified this coordination mechanism as a new and broadly applicable instrument of EU governance.<sup>1</sup> The underlying ‘new governance’ idea is not to impose rigid regulatory standards but to share experience about national “experiments that are adapted to local circumstances, while fostering policy improvement, and possibly policy convergence, through institutionalized mutual learning processes” (Eberlein and Kerwer 2004, 123). Against this background, the OMC was touted as the “third way” in EU governance, to be used when “harmonisation is unworkable but mutual recognition and the resulting regulatory competition may be too risky” (Trubek and Mosher 2001, 21). Scholars began to identify implicit patterns of OMC-style new governance in a large number of policy areas, well beyond the OMC core of economic policy co-ordination, employment and social policy: examples are immigration, the environment, research and innovation and taxation. The initial excitement surrounding OMC and new governance, however, has made room for a sober and often skeptical assessment of its merits and limits in empirical practice (e.g. Borrás and Greve 2004 but also see Zeitlin and Pochet 2005).

On a conceptual level, New Governance is now being analyzed in the context of more sophisticated typologies of different modes of governance. Many adopt an Europeanization perspective distinguishing between different degrees of binding-ness in policy formulation on the one hand and different degrees of discretion in policy implementation on the other hand. ‘New’ governance is typically associated with non-binding or low-obligation type of policies that give actors a high degree of discretion or flexibility in implementation (e.g. Knill and Lenschow 2004). The stylized juxtaposition of old versus new governance is being replaced by a continuum of governance that locates different practices along a common variable such as the degree of supranational coordination (NEWGOV 2005). Closer analysis reveals that some practices that are considered as new in one area might have been “long-established practices in other areas” (Treib, Bähr, and Falkner 2005, 4). And, most importantly, it is recognized that in practice, ‘old’ and ‘new’ modes are selected and combined in various ways (embedded, sequentially ordered, etc.), and that they need to be studied in their shifting interaction and development, not in artificial isolation or dichotomy (e.g. Radaelli and Kraemer 2005). We depict the continuum in Figure 1 as varying on two axes – the locus of coordination which shifts from national to supranational and the mechanism of enforcement which shifts from formal to self-policing. The modes of governance labels are borrowed from Wallace (2005).

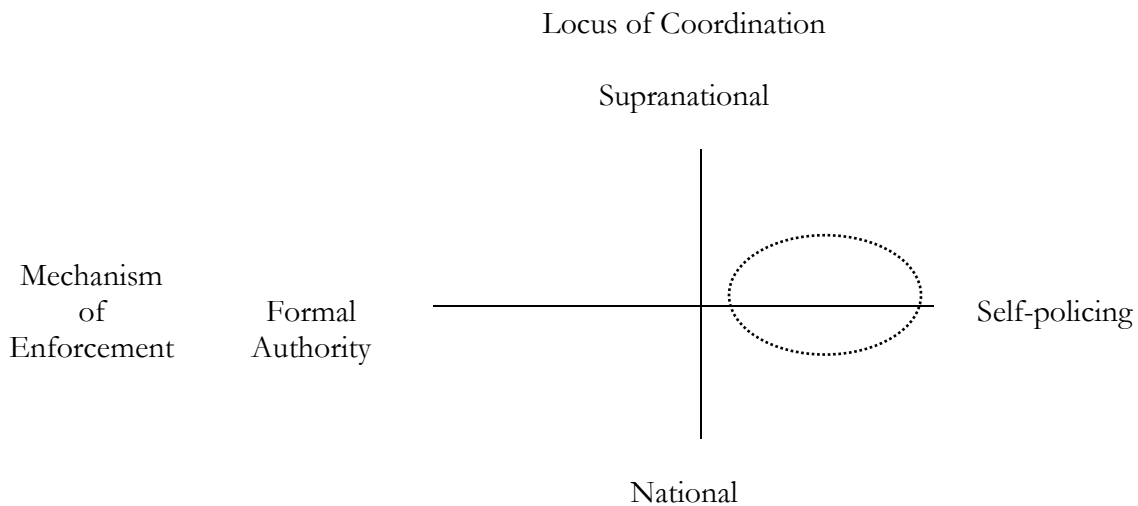
*Figure 1: Modes of Governance in the EU*





Notwithstanding these sophistications in the scholarly conversation on EU governance innovations<sup>2</sup>, the debate focuses predominately on patterns that are non-regulatory and eschew formal authority. The emphasis is very much on cooperative/negotiated or deliberative techniques of decision-making that are contrasted with the use of legal, formal authority as depicted by the dashed oval in figure 2 (e.g. Börzel, Guttenbrunner, and Seper 2005, 6).

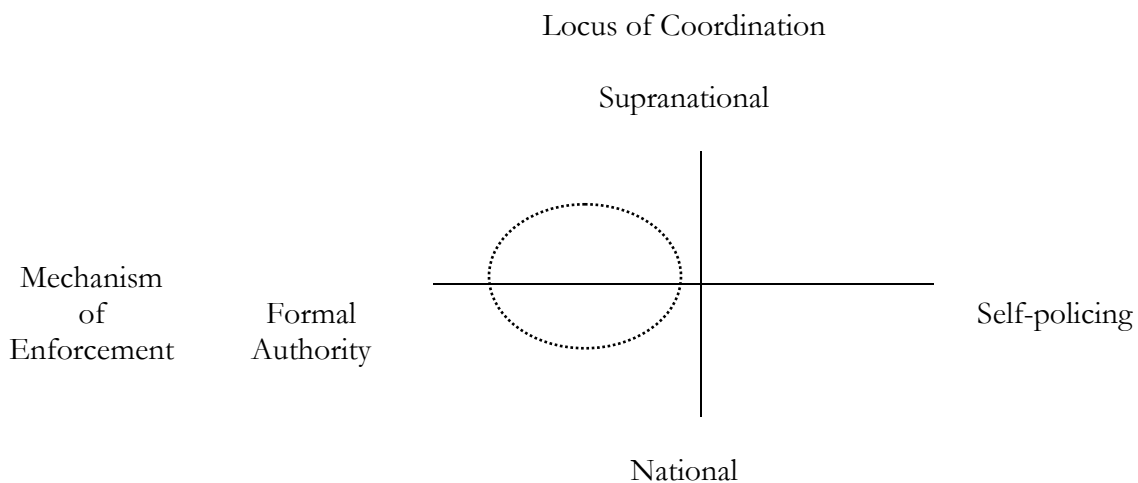
Figure 2: Current focus of new governance research



The central argument of this paper is that the prevailing focus on non-binding, deliberative, OMC-style types of new governance tends to overlook an alternative and, in practice, increasingly important exit from the regulatory dilemma: *incorporated transgovernmental networks*. This space of governance modes is depicted by the dashed oval in figure 3. In a range of sectors from financial services to utilities, the EU has formally incorporated

organized groups of national regulators into a novel, network-type of regulatory process. These incorporated transgovernmental networks take on critical roles in defining and enforcing European rules. *They produce binding rules, while resting on a complex web of multilevel authority.* As these networks confront the challenges of harmonizing diverse European markets, network participants enjoy significant domestic regulatory authority. They may then simultaneously leverage both supra- and national authority to coordinate European projects.

*Figure 3: Incorporated Transgovernmentalism*



The goal of this paper is to offer an initial window into this innovative governance technique. As such, it is organized around three sections. The first presents a thorough description of incorporated transgovernmental networks and its main components. This is followed by detailed case studies in two critical sectors, data privacy and energy. The cases are employed to flesh out the analytic category, building a more robust theoretical typology of European governance (George and Bennett 2005). While data privacy offer the earliest and most developed example of incorporated transgovernmentalism, the energy sector represents a host of policy domains for which the ongoing rise of incorporated

transgovernmentalism is closely tied to the recent expansion of the regulatory state in Europe.

The final section concludes by addressing the implications of this new governance mode for policy-making efficiency, legitimacy, and the distribution of power within multi-level governance.

### **The Second Escape: Incorporated Transgovernmentalism**

In an effort to manage the dilemmas posed by the regulatory method, the European Union has experimented recently with innovative governance tools. While the academic literature has actively investigated self-enforcing techniques that flatten supranational hierarchy – most notably the Open Method of Coordination – additional innovative mechanisms emphasizing binding enforcement have also been created. *Incorporated transgovernmentalism* provides a critical example of this new tool in the European regulatory palette.

This strategy officially incorporates transgovernmental networks into the supranational governance process. Transgovernmental networks are comprised of sub-national actors (such as independent regulatory authorities) that meet and interact with their counterparts from other nations (Slaughter 2000; Raustiala 2002). In incorporated transgovernmentalism, these networks, whose existence often predated incorporation, are integrated through European law into the supranational policy-making process. European legislation establishes new formal cooperative bodies with dedicated secretariats, funded and supported by the European Union. These networks are then granted the authority to participate in EU rule-making, enforcement, and implementation. Specifically, they serve to advise the Commission, draft implementing legislation, coordinate national enforcement, promote information exchange among national regulators, and make recommendations to

the public on emerging regulatory issues. This means that these regulatory groups organize and interact with sectoral stakeholders as supranational legislation is developed and at the same time devise on-the-ground strategies for implementation. In some sectors, such networks have come to replace or have been layered on top of traditional comitology procedures, raising the stature of national regulators vis-à-vis other EU actors, such as the European Parliament. In other words, European institutions have formally delegated supranational authority to networks of sub-national actors.

The move to integrate transgovernmental networks into the formal supranational regulatory process is a logical, yet a unique, extension of traditional transgovernmental efforts in Europe. National expert networks have long played an active role in European politics (Dehousse 1997). They advise the various European institutions and constitute the substructure of many of the European regulatory agencies. Pan-European agencies active in areas ranging from discrimination to the environment serve as central nodes in information exchange among national experts. European political institutions can leverage the expertise in these networks to fill information gaps and the networks offer to inject transparency into supranational politics. This governance by information, as coined by Majone, focuses on highlighting differences and disparities across member states but rarely delves into issues of regulatory enforcement or development (Majone 1997). In the case of incorporated transgovernmentalism, such networks are not only information warehouses but become independent political institutions with the authority to shape rule-making and rule-enforcement. To be sure, these networks, too, use informal policy mechanisms such as information sharing in their day-to-day practice. Yet, we argue that their distinctive character lies in the fact that they simultaneously wield power over rules as national regulators vested with domestic authority and formally coordinate the supranational regulatory framework.

The move to incorporate transgovernmental networks into supranational policy making has important implications for literatures on international governance. Research on global governance has expanded the number of relevant actors in international affairs to include transnational corporations, international organizations, and non-governmental organizations. Here scholars have isolated how these actors shape and influence international politics (Strange 1996; Keck and Sikkink 1998; Tarrow 2005). The complexity of the state itself, however, is rarely the focus of such studies. At the same time, work on transgovernmental networks has examined how sub-state actors have organized to resolve many emerging governance dilemmas. This work has examined the work within such networks: their ability to share information with their national counterparts or cooperate to enforce shared principles (Bermann 1993; Slaughter 2004). The argument presented here fills an important gap in these existing research literatures by examining how transgovernmental networks directly interact with other international actors. As such, the study forces transgovernmental research to look outside of the networks themselves and scholars of “new” global actors to take seriously the implications of the disaggregated state for the politics of global governance.

Incorporated transgovernmentalism has become a fast growing governance mechanism in the European Union. Many major sectors now have a transgovernmental network that is officially embedded in the supranational policy-making process (for examples see table 1). These networks are most often composed of member state national regulatory authorities. As such, the move towards incorporated transgovernmentalism is deeply tied to the development of the regulatory state in Europe over the last twenty years (Majone 1996). With sectors ranging from telecommunications to energy liberalized and state industries privatized, arms-length regulations that enforce and manage market competition have

replaced direct command and control state intervention (Héritier 2002). Independent, “non-majoritarian” regulatory agencies have been created to oversee such markets (Coen and Thatcher 2005, Gilardi 2002). While this form of government was first popularized during the New Deal and Great Society in the United States, it started to gain widespread traction in Europe in the 1970s (Thatcher 2002; Thatcher 2005). European Union legislation has actively encouraged this development in a host of sectors by adopting legislation that requires all member states to create independent regulatory agencies. As a result, implementation and enforcement at the national level has increasingly shifted away from executive ministries to independent regulatory agencies. This regulatory revolution at the national level has then facilitated the rise of incorporated transgovernmentalism as national regulators have been appointed and become available to coordinate a viable supranational governance strategy.

*Table 1: The Rise of Incorporated Transgovernmentalism*

<b>Issue Area</b>	<b>Name</b>	<b>Incorporation Year</b>	<b>Directive</b>
Banking	Committee of European Supervisors (CEBS)	2003	Commission Decision of 5 November 2003 establishing the Committee of European Banking Supervisors
Competition Policy	European Competition Network (ECN)	2002	Council Regulation of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty
Data Privacy	Working Party on the Protection of Individuals with regard to the Processing of Personal Data (Article 29 Working Party)	1995	Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data
Electronic Communication	European Regulators Group (ERG)	2002	Commission Decision of 29 July 2002 establishing the European Regulators Group for Electronic Communications Networks and Services
Energy	European Regulators Group for Electricity and Gas (ERGEG)	2003	Commission Decision of 11 November 2003 on establishing the European Regulators Group for Electricity and Gas
Insurance	Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)	2003	Commission Decision of 5 November 2003 establishing the European Insurance and Occupational Pensions Committee
Securities	Committee of European Securities Regulators (CESR)	2001	Commission Decision of 6 June 2001 establishing the Committee of European Securities Regulators

Incorporated transgovernmentalism relies on the collective expertise, network ties, and regulatory authority of member participants to build an effective governance strategy.

Horizontal networks of member state regulators may draw on the collective experiences of its members to assess regulatory needs and monitor compliance (Slaughter 2004). They are then well positioned to develop new legislative proposals and assess firm behavior in their sectors. European institutions rely on this expertise in both regulatory development and enforcement efforts (Ziegler 1995; Barnett and Finnemore 2004). In addition to the information advantage, network members may mobilize their relationships with actors from their respective domestic political settings (Padgett and Ansell 1993; Carpenter 2001). Many national regulators have developed close working relationships with both industry and national elected officials. These network ties prove critical as implementing legislation is developed or evaluated. Furthermore, as policy is crystallized transgovernmental groups can work with national industry to assure proper adoption.

Finally, and most importantly, transgovernmental groups are composed of actors with domestic regulatory authority. Often empowered to reprimand non-compliance, levy fines, or bar market access, network members enter negotiations or enforcement activities with real regulatory power. They can leverage the varying degree of delegated authority across participating network members to augment their own domestic authority. Regulators that identify a problem in their home jurisdiction but lack regulatory powers can raise the issue in the network to motivate enforcement by those with the requisite authority. Far from simply participants in a discussion, such networks may use their expertise to frame agendas and then leverage their network ties and delegated domestic authority to rally support and manage compliance.

The incorporation of transgovernmental actors exemplifies the diversity of governance modes possible in a system of multilevel governance (Hooghe and Marks 2001). These networks have been delegated authority at the supranational level to coordinate policy

development and implementation at the same time that they rely on domestically delegated authority to enforce their decisions. As such, incorporated transgovernmental networks collapse the traditional image of the two-level game in international politics (Evans, Jacobson et al. 1993). Independent regulators in these sectors simultaneously act to enforce national rules and develop and coordinate supranational policy.

### **Incorporated Transgovernmental Networks in Practice**

In order to extrapolate on the depiction of incorporated transgovernmental networks as a significant addition to a typology of EU governance, we present two case studies that identify their origins, structure, and day-to-day operations (George and Bennett 2005). The cases represent the two temporal extremes with data privacy as the first example of incorporated transgovernmentalism and energy as the most recent. This offers a useful contrast highlighting how the governance mode has evolved over time. Moreover, the two cases cover both economic regulation (of market access and conditions in energy) and social regulation (consumer protection and control of negative externalities in data privacy). The case of privacy exemplifies a bottom-up process whereby the network was then incorporated into supranational policy-making while the energy case demonstrates a much more active role by the Commission and the EU in constructing the network, its members, and the final incorporation.

#### **Data Privacy**

Starting in the late 1960s, governments and businesses across the advanced industrial societies began investing in large mainframe computer systems. Proposals emerged to construct large consumer and citizen databases in order to increase efficiency, better target services, and minimize fraud. These initiatives hoped to inter-link a wide range of personal

data ranging from welfare receipts to consumer purchases to rationalize operations. Such organizational optimism, however, quickly confronted a powerful set of interests that opposed such efforts under the banner of privacy (Hondius 1975).

An alliance formed between groups that feared the expansion of executive authority and those concerned with the concentration of power in big business. Legislators across Europe engaged study commissions to examine the effects of computers on personal freedom. A group of socially active lawyers interested in the interaction between law and technology worked in these groups to devise comprehensive rules to govern this new policy area (Newman 2005). By the end of the 1970s, a core set of countries including France, Germany, and Sweden had adopted comprehensive data privacy legislation. These laws established a clear set of rules for the collection, processing, and exchange of personal information for the public and private sectors (Bennett 1992). Additionally, they created new independent regulatory institutions – data privacy authorities – that were empowered to monitor and enforce the new regulations. Although the exact powers vary somewhat across the member states, generally, these agencies have the authority to advise their governments on issues pertaining to data privacy, maintain registries of databanks, investigate and sanction violations of the law, and communicate publicly on critical issues in the field. Concerned that large multinational corporations might transfer personal information to countries with lower regulatory standards, many of these data privacy authorities were also delegated the authority to regulate interstate information exchanges.<sup>3</sup>

These young regulatory bodies quickly took up the transnational issues associated with cross-border information exchanges. It was clear that both multinational businesses and European governments would share information across jurisdictions. Regulators from nations with comprehensive rules feared that this would place their citizens' privacy at risk

and jeopardize their newly acquired regulatory authority (Hondius 1975). In order to meet this transnational challenge, the regulators formed a transgovernmental association, which met annually at the International Data Protection Commissioners' Conference starting in Berlin in 1979.<sup>4</sup> Multiple working groups were formed to examine critical cross-border such as telecommunications and data privacy authorities worked through multiple international organizations to formulate a coherent set of international norms.<sup>5</sup> Early efforts included a set of fundamental data privacy principles, which were agreed upon in 1980 by the Organization of Economic Cooperation and Development (OECD), and a Council of Europe Convention on the processing of personal information in 1981 (OECD 1980; Council of Europe 1981). While these agreements codified a set of fundamental privacy principles and confirmed the international dimension of the issue, they failed to solve the problem of regulatory arbitrage. Both relied on national implementation legislation and by the end of the 1980s a third of the European Community had not yet adopted comprehensive rules. European data privacy authorities, then, began working to develop concrete proposals for a European Community proposal.<sup>6</sup>

Prodded by the demands of the European data protection authorities, the European Union adopted a directive for the protection of personal information in 1995.<sup>7</sup> The directive requires that all member states implement comprehensive regulations, supervised by an independent regulatory authority. The directive also includes an extra-territorial clause that prevents the transfer of personal information to countries outside of Europe that have failed to adopt adequate protections.

In addition to requiring member state action, the directive formally established the first incorporated transgovernmental network within the European Union. Article 29 of the directive calls for the creation of a working group of national data privacy authorities. The

Article 29 Working Group is empowered to advise the Commission on emerging data privacy concerns facing the EU, make recommendations regarding the implementation and enforcement of the directive, and evaluate the adequacy of levels of protection in countries outside of the EU. The Commission supports a secretariat for the Working Group in Brussels which has greatly enhanced transgovernmental cooperation. The Working Group has an annual work plan, which is run collectively by the members and is steered by a Chair elected from the national privacy authorities. Sub-groups of officials from the various agencies meet regularly on topics ranging from biometric data to Internet cookies. These efforts are supported by the financial, technical, and linguistic resources of the Commission sponsored secretariat.

Since its formation in 1997, the Working Group has actively engaged supranational rule enforcement and development in the area of data privacy. They have released over 100 opinions on a wide range of topics; setting guidelines for national implementation of the directive; calling for or evaluating new European legislation; determining the adequacy of protection levels in foreign countries.<sup>8</sup>

These opinions have had far reaching effects for national enforcement within Europe, shaping the implementation of the directive. The Working Party's opinions have been interpreted by courts as part of the directive's legislative intent and have been enforced (UNICE 2002). The Working Party has set standards as diverse as the use of Internet cookies to biometric data. Business practices determined unacceptable by the Working Party face potential punishment by national regulators (who conveniently comprise the Working Party). The Working Party then relies on regulatory authority delegated in the national context to coordinate policy across Europe.

Internationally, the Working Party has played a major role in shaping the external enforcement of the directive. The Working Party has evaluated foreign country efforts, releasing a set of adequacy rulings. Threatened with being excluded from the European market, countries ranging from Albania to Argentina have modeled European rules (Heisenberg and Fandel 2002). Those countries deemed inadequate such as Australia and the United States have been forced to engage the European Union in international negotiations (Farrell 2003; Heisenberg 2005; Newman 2005). The Commission relies on the argumentation of the Working Party to constrain its bargaining position with delegates from other countries and improve the resulting international settlement.

In the area of rule-development, the Working Party actively advises the European political institutions on new areas affecting privacy. While these opinions are not binding, they have played a significant role in European policy-making. On a recent debate over the retention of telecommunications data, the Working Party warned that initial proposals from the Council would violate the European Human Rights Convention (Article 29 Data Protection Working Party 2004). These warnings were then taken-up by the European Parliament in its effort to scale back the initial Council proposal. Not only was the argumentation of the Working Party integrated into the debate, but they will be part of a committee including parliamentarians, industry, and law enforcement that will monitor the implementation of the new legislation. The Working party has taken up a host of other issues in their work plan where rule-development is in progress including on-line authentication, SPAM, and biometric data in passports.

Data privacy offers the earliest example of incorporated transgovernmentalism in the EU. As one of the first sectors in Europe to experiment with independent regulators (the French data privacy authority, for example, was one of the first independent regulator to be

created in France), it has been at the cutting edge of the development of the European regulatory state. This long tradition of delegation in the area combined with the natural transnational character of cross-border data flows made data privacy a logical case to expect transgovernmental cooperation. Interestingly, as the EU moved to enter the sphere of data privacy regulation in the 1990s to facilitate the integration of the internal market they have relied on the expertise and domestically delegated authority to guide implementation and harmonization in the issue area. The Article 29 Working Group has then actively participated in managing the implementation of the directive and promoting harmonization within the member states at the same time that it has shaped the future course of privacy policy at the supranational level.

## **Energy**

Whereas transgovernmental networking between national agencies has a long history in data privacy, it is a nascent phenomenon in the energy (electricity and gas) sector. The emergence of incorporated transgovernmentalism is closely linked to the recent transformation of the industry and the rise of the regulatory state in the utility sector (e.g. Coen and Héritier 2006; Coen and Thatcher 2001).

Until the early 1990s, the European electricity and gas industries were essentially organized as public utilities in a closed national context. Since electricity and gas supply depend on network infrastructures involving specific, capital-intensive assets, the entire sector was regarded as a natural monopoly. The industries were mostly held in public ownership, or heavily regulated, with executive ministries, not independent agencies, as key players. Sector governance was deeply entrenched in the broader political economy of individual countries. Cross-border exchanges in electricity were very limited and only technical in nature.

While European integration originated in the energy sector (ECSC and Euratom), earlier attempts to develop a supranational energy policy invariably failed.<sup>9</sup> The dual perception of energy as an essential, public service and as a strategic national resource prevailed and blocked market reforms. In addition, the vast differences between national power sectors, in terms of the mix of energy inputs, the degree of import dependence, and of ownership structures, undermined attempts at European-level harmonization.

This picture only changed in the early 1990s when two developments intersected: globally, the liberalization movement seized the realm of infrastructure and utilities; and the energy sector in Europe was successfully incorporated into the Single Market agenda by an activist and skillful Commission. Technological change and global competition drove reform much less than in the telecommunication sector, where the digital revolution undermined natural monopoly features (Bartle 2005). Moreover, the advocates of liberalization were opposed by a powerful alliance of incumbent utilities and national governments. Hence, the success of liberalization hinged considerably on the skills of the Commission to pull the energy sector into the Single Market mould and to reframe energy as amenable to the powerful market norm (Jabko 2005). The apparent success of electricity liberalization in Britain (1990), the first major country to implement industry restructuring, served as important ‘anchor’ and provided a welcome reform template that was “uploaded” to the EU-level (Padgett 2003).

Yet, the road towards liberalization and EU-level policies, launched in 1988 with the Working Paper on the Internal Energy Market, was protracted and slow. The decisive breakthrough was achieved with the Electricity Directive (96/92/EC) in 1996 (followed by the Gas Directive, 98/30/EC in 1998). The deadlock in Council negotiations was broken by

a Franco-German agreement that accepted the principle of market opening and regulatory reform (e.g. Eising and Jabko 2001).

However, given the political resistance to liberalization and European harmonization, the legislation prescribed only incremental and moderate market opening, and it left member states a large margin of discretion regarding crucial regulatory issues such as the regime of access, for new market entrants, to the monopoly networks. The Directives also failed to establish rules for cross-border trade between individual markets. The result was a European patchwork of national rules, not a level playing field. Yet, the idea of open energy markets gained ground, and many member states went beyond the requirements of the Directive and opted for faster and more comprehensive liberalization and regulatory reform. Following the British template, many countries created new regulatory agencies, the future building blocks of regulatory networks. To varying degrees, these agencies acquired some regulatory powers that would otherwise be held by executive ministries.<sup>10</sup>

The Commission built on this momentum, and on the Lisbon Agenda drive for competitiveness, to press for further legislation. The 2003 Directives for Electricity and Gas<sup>11</sup> delivered a more robust EU framework. A firm date for full market opening (July 2004 for non-household costumers, July 2007 for all costumers) was set, and stricter rules for national network access regimes and unbundling (of non-competitive and competitive industry segments) were put into place. Yet, the common rules still allow for “considerable scope for diversity in implementation among the Member states” (Cameron 2005, 8).

Politically, it was not an option to require full harmonization, or to delegate formal regulatory powers to the Commission, let alone to establish a new EU Energy Regulator. Instead, the EU framework relies on national regulatory authorities to enforce existing EU-level rules, to develop new ones, and to coordinate national implementation (Eberlein 2005).

Crucially, the 2003 Directives made it mandatory for member states to have independent regulatory authorities with a minimum set of functions and competences to regulate national energy markets. This was to ensure that regulatory laggards, such as Germany, would fall into line with the agency model of market regulation and move away from ministerial or self-regulatory patterns. Also, the legislation required regulators to cooperate with each other and the Commission in order to develop a level playing field.<sup>12</sup> These measures laid important foundations for networking between national regulators.

Early on in the process, in the aftermath of the 1996 Electricity Directive, the Commission's strategy was to compensate for the lack of full regulatory powers by establishing alternative mechanisms of coordination between member state policies. Transgovernmental networks in the energy sector originated in this context.

The most prominent avenues were the Florence Forum for electricity and the Madrid Forum for gas, set up in 1998 and 1999 respectively.<sup>13</sup> These informal fora, set up by the DG Energy and Transport, meet biannually and brought together national regulators and ministries, and important market actors and stakeholders, such as network operators, representatives of the electricity or gas industries, as well as industry consumers and traders. As informal bodies they develop 'best-practice' rules and procedures for sector regulation, based on professional standards and industry expertise. The practical challenge was to develop a system of cross-border trade, the linchpin of an integrated energy market. To be sure, the process was slow and at times had to be prodded by casting the shadow of new legislation or competition law. Yet, under Commission leadership and with industry input, the Florence and Madrid processes successfully produced rules for cross-border trade (rules for the use of transmission networks and of scarce interconnection capacities). These

voluntary rules were later incorporated into binding EU Regulations on cross-border trade as part of the 2003 legislative package.<sup>14</sup>

The Forum formula also played a crucial role in building institutions to federate national regulators in EU-level networks. In March 2000, the Council of European Energy Regulators (CEER) was constituted based on a memorandum of understanding.<sup>15</sup> It brings together the energy regulators from all EU member countries (except Luxembourg) plus Norway and Iceland. The main purpose is to facilitate the creation of an internal energy market by fostering cooperation between national regulators, and with EU institutions. Operating out of a small office in Brussels and organized around issue-specific Working Groups and Task Forces, its mission is to help develop an EU energy regulatory framework. The Commission encouraged this regulatory institution-building by mandating CEER, a body without formal regulatory powers, to develop a system for cross-border trade within the Forum context, thus promoting CEER as single regulatory voice on the EU level. CEER, in concert with the Commission, was the main driver of the Forum process.

CEER provided the organizational foundation for the recent incorporation of transgovernmentalism in the energy sector. In November 2003, the Commission created the “European Regulators Group for Electricity and Gas” (EREG), to give informal cooperation between national regulators a more formal status. Formalization and incorporation was to address the drawbacks of the informal and more inclusive Forum process that lacked regulatory teeth and appeared cumbersome, particularly in view of the approaching EU-25 context.

The purpose of this advisory group is “to advise and assist the Commission in consolidating the internal energy market”. In particular, the Group’s objective is to facilitate “consultation, coordination, and cooperation of national regulatory authorities, contributing

to a consistent application” of Community legislation.<sup>16</sup> The Regulators Group is run collectively by the members and is steered by a Chair. The Commission provides funding for some ERGEG activities, and a high-level member of the Commission attends Group meetings. The Group is organized in sub-groups of national officials from the various agencies that meet regularly on topics such as cross-border tarification and regional electricity markets.

CEER continues to co-exist with the Regulators Group, and the two bodies essentially represent two faces of one network: CEER prepares material for ERGEG and continues to facilitate informal cooperation, while ERGEG provides formal advice to the Commission.<sup>17</sup>

On substance, therefore, much of CEER’s work on regulatory harmonization in the internal market, initiated under the Forum Process, continues under a different label. However, and crucially, the incorporation of the network into the supranational regulatory framework allows the Commission to draw more effectively on the domestic regulatory authority of national agencies, while the Group’s formal status helps national regulators to assert their position in the domestic arena. Since the growth of the regulatory state is a very recent phenomenon in the energy (and other) sector, most agencies, with the exception of Britain, are young regulatory bodies - they still need to establish themselves, jockeying for influence with established ministries and competition authorities.

Compared to the well established agencies and regulatory networks in data privacy, the regulatory state and incorporated transgovernmentalism in the energy sector are at an early stage of development. In a politically difficult context, regulatory reform and transnational networking so far owe more to skillful Commission engineering than to bottom-up self-organization by well-entrenched agencies. In the energy case, agencies are

just emerging as ‘new kids on the bloc’ in a nascent regulatory state, bolstered and enlisted by the Commission in an effort to advance harmonization.

### **Implications and Conclusions**

As the tasks managed by and the members participating in the European Union expand, European leaders face the daunting challenge of maintaining an efficient and legitimate system of governance. Scholars of the European Union have rightly recognized that, in terms of policy modes, a palette of options exists, each with their respective fields of application, and advantages and disadvantages (Wallace 2005). Attention to this point has rightly focused on the regulatory method, intergovernmentalism, and on new governance patterns such as the Open Method of Coordination. While all of these strategies will no doubt persist in the coming decades, we hope in this paper to spur a discussion about a new and innovative governance mode that is emerging as a viable strategy for a range of sectors within Europe. We have labeled this strategy *incorporated transgovernmentalism*.

In this concluding section, we argue for the distinctiveness of this new strategy, and we discuss how incorporated transgovernmentalism relates to the three critical issues that face any governance mechanism within Europe: efficiency, legitimacy, and power.

#### **A Distinct Mode of Governance?**

In this new governance mode, transgovernmental networks comprised of sub-state actors are consciously embedded in the supranational policy-making process. Explicitly granted the authority to assist in rule-development and enforcement, incorporated transgovernmental actors oversee the harmonization process and guide further integration. They combine supranational coordination within the transgovernmental body with national

delegated authority. Their decisions then simultaneously inform EU policy and actual enforcement on the ground.

What is distinctive about incorporated transgovernmentalism compared to other policy modes? This mode is different, on the one hand, from OECD-style ‘policy coordination’ (Wallace 2005) and OMC processes in that it does not exclusively rely on deliberative mechanisms and peer pressure but that it can bring delegated authority to bear. In that sense, it borrows from the traditional regulatory method, but on the basis of *domestic, horizontally delegated* authority. On the other hand, it is also different from ‘intensive transgovernmental’ cooperation that is often practiced in areas that are not subject to supranational authority. Incorporated transgovernmental networks, by contrast, are exactly that, firmly incorporated in a supranational framework and mode of operation, while resting on domestic, governmental authority.

Incorporated transgovernmentalism is on the rise. For the last decade, the EU has been experimenting with this form of governance and it is currently at work in seven sectors ranging from banking to energy. While not an option available in all policy domains, we believe that such networks are particularly attractive in sectors where there has been a significant expansion of the regulatory state. This then brings us to the critical questions of efficiency, legitimacy, and power.

### **An efficient mode of governance?**

An initial analysis suggests that this innovative strategy could surpass some of the traditional approaches in terms of efficiency. It was, after all, the burden of the regulatory method which motivated European policy officials to advocate for the incorporated transgovernmental approach in the area of financial services. The “group of wise men” in the Lamfalussy report explicitly argued that such a strategy could speed up the legislative

process both in rule development and implementation (European Commission 2001). By relying on national independent regulators to work out the specifics of implementing directives, the process removes much of the time consuming back and forth among the European institutions. It also often removes the need for some national implementing legislation, as independent regulators can directly enforce decisions taken in the transgovernmental network.

This strategy naturally relies on the existence of national regulatory bodies that can be effectively organized transgovernmentally and that can produce consensual policies. Efficiency breakdowns may occur if there is considerable disagreement amongst the regulators on a particular policy issue. Such disagreements are mitigated by the common training and policy approach of many members of these committees (Majone 2000). As has been demonstrated in areas as diverse as central banking and the environment, regulatory agencies often share a common policy world view that promotes common agenda setting and a ‘cosmopolitan’ rather than ‘local’ perspective). Professionalization is the most important driver of convergence in this regulatory context.

A more critical requirement for efficiency is that the independent regulators must have significant domestic authority to carry out the tasks of managing a sector. Where independent regulators are weak, we anticipate that such solutions will quickly devolve into intergovernmental governance with governments asserting their interests in the field. Governments are more likely to undermine the independence of regulatory agencies if technical complexity or uncertainty is low and issue salience is high, a combination that invites politicization (Eisner, Worsham, and Ringquist 2000, 29). Regulators may also be weak in regards to their effective independence from and control over the regulated industry, which raises the classical danger of regulatory capture. In the utilities sector, for example,

problems such as information asymmetry between new regulators and powerful incumbents abound.

Strength or weakness of an independent regulator is not only a function of substantive expertise and organizational and financial resources. These are necessary but not sufficient elements. The crucial variable is delegated, regulatory authority.

Governments may decide to delegate powers to independent regulators for a variety of reasons (e.g. Huber and Shipan 2002; Thatcher and Stone Sweet 2002): they require the regulators' expertise in an increasingly complex policy world, they seek to shift or avoid blame, or the government of the day seeks to entrench and protect its policy choices from intervention by future governments. The dominant approach in the literature has argued, from a principal-agent perspective, that delegation is a function of transaction costs – in particular of the need for 'credible commitment' (e.g. Majone 1999; for a more contextual approach see Elgie 2006). In the utility sector, for example, agency delegation signals to private investors that, by tying their hands, governments are committed to protect private long-term investments (Levy and Spiller 1996). Given the effects of path dependency, initial decisions about institutional design based on the principal-agent demands facing the principal in the period of institutional creation often have long-term effects on the regulatory authority of an independent agency in a given sector (Pierson 2004). The extent of national delegated authority, whether the result of institutional stickiness or existing principal-agent needs, plays a critical role in the ability of such incorporated networks to manage the supranational demands of a sector. However, it is important to recognize that delegated authority is embedded in a larger "regulatory regime", composed of a variety of actors that operate in a domain and jurisdiction specific 'regulatory space'. The type of regime will

impact the effective degree of authority that can be exercised by an independent agency (Eberlein and Grande 2005).

### **A legitimate mode of governance?**

While incorporated transgovernmentalism could, in some circumstances, help to resolve the efficiency concerns raised by European governance challenges, it has a more complicated relationship to legitimacy. Composed of independent regulatory agencies, these networks derive less legitimacy than those modes sponsored by directly elected officials. In transgovernmental networks, non-elected officials exercise substantial regulatory powers. More often than not, these networks are effective insofar as and because they are deliberately isolated from electoral-political pressures. While this helps to increase ‘output legitimacy’, which rests on expertise and policy efficacy, it poses a serious problem for ‘input legitimacy’ and accountability (Dahl 1994; Scharpf 1999). Furthermore, regulatory networks can be criticized for introducing substantive policy bias. Technical expertise and professionally defined ‘best-practices’ are not neutral. They privilege certain worldviews and interests over others. In the case of the energy regulatory community, for example, the economic training of many regulators has resulted in much greater attention to issues of market-making than to environmental protection or security of supply.

On the other hand, each agency was appointed by an elected national government and therefore enjoys a marginal amount of procedural legitimacy. In contrast to many EU institutions that have little direct contact with national constituencies, members of incorporated transgovernmentalism have a multitude of relationships with sector participants. They may then leverage these relationships to get input on critical policy areas, embedding a diverse set of interests into the transgovernmental rule-making and rule-

enforcing processes. Obviously, access to and influence on regulatory decisions is not equally available to all citizens. This type of ‘stakeholder participation’ may produce some level of input legitimacy, but it clearly does not confer democratic legitimacy. Yet, while limiting participatory inclusion (especially when compared to some new governance strategies such as OMC) to those active in the sector, the incorporated transgovernmental approach may surpass traditional technocratic governance by better integrating national constituencies.

That being said network participants are not always endowed with equal voice within such networks (Padgett and Ansell 1993). National decisions limiting domestically delegated authority circumscribe the resources an individual regulator brings to the network, affecting their influence within the network. Regulators with similar national regulatory systems may also form coalitions within the network that exclude the policy preferences of those with idiosyncratic domestic regulatory structures. In short, the distribution of power and influence among the players in the transgovernmental network will shape the ability of such networks to obtain legitimacy within the European policy-making process.

What about the ‘non-majoritarian’ escape from the dilemma of democratic legitimacy that is advanced by some scholars in the regulatory state debate? This avenue proposes to limit the powers of independent, non-elected regulators to non-distributive, Pareto-optimal decisions that can be assessed and legitimated based exclusively on their technical quality. Political, distributive decisions, by contrast, remain in the realm of majoritarian, representative politics (Majone 1999, 2000). Firstly, it is difficult to see how technical issues can be unequivocally separated from distributive or political issues. Also, this route would require a high degree of US-style formalization of agency decision-making, so that procedural standards of reason and transparency are effectively observed. It seems unlikely that the often informal operation of transgovernmental networks could be successfully

subjected to this type of procedural control and transparency. Hence, the conundrum of democratic legitimacy remains unresolved.

### **Incorporated Transgovernmentalism as Shift of Institutional Power?**

Finally, with regard to power, the approach has several interesting implications. At the supranational level both the Commission and the Parliament must relinquish some power in order for such networks to function. By implicitly delegating some rule-making and rule-enforcing to national regulatory agencies, the European institutions have forfeited direct control over a policy area. This does not mean that these European institutions are no longer significant actors. But it shifts the dynamic, whereby the Commission loses some of its agenda setting authority and the Parliament some of its oversight power. As a result, the Commission and the Parliament must struggle to monitor the activities of such networks to protect against mission creep. The Parliament's recent concerns over the authority of CESR in the area of financial services demonstrate the real institutional implications of this strategy. At the same time, the networks can provide the Commission or the Parliament with invaluable technical information, which they may then leverage in their debates with member state governments. Additionally, the European institutions may come to rely on the networks as a means to mobilize national constituencies, increasing policy buy-in. In short, such networks have a Janus-faced effect on the distribution of power at the supranational level. From a member state perspective the rise of incorporated transgovernmentalism may have a paradoxical boomerang effect. Member states have in most areas resolutely resisted the formal delegation of regulatory powers to EU agencies in order to retain national control. Now they may find that horizontal delegation to domestic regulators might result in a similar loss of control as national regulators collectively leverage domestic authority to advance supranational harmonization.

In sum, the addition of incorporated transgovernmental networks into European governance may have dramatic implications for the future of European integration serving both to respond to needed policy challenges and to add a host of new actors to supranational politics.

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<sup>1</sup> OMC is a procedure designed to foster iterative processes of mutual learning by way of joint target-setting and peer review as well as benchmarking of member state experiences under broad and unsanctioned European guidance. There has been a burgeoning literature on the OMC. The most comprehensive and updated literature overview is provided by the OMC Research Forum at the EU Center of Excellence, University of Wisconsin-Madison (<http://eucenter.wisc.edu/OMC/>). For discussion of OMC as governance instrument see for example (Borrás and Jacobsson 2004; de Burca 2003; Radaelli 2003).

<sup>2</sup> Much of this debate takes place within the context of the EU FP6 Integrated Project “New Modes of Governance” ([www.eu-newgov.org](http://www.eu-newgov.org)).

<sup>3</sup> While these agencies were universally independent, their exact regulatory powers differed somewhat across Europe. Some had clear powers to investigate and sanction while others were granted an ombudsperson status, focusing on mediating complaints. For a detailed explication of the regulatory structure and delegated authority of these institutions see (Flaherty 1989). These powers, however, have been equalized to a degree through the passage of the European directive in 1995.

<sup>4</sup> For a description of the first conference see *Transnational Data Report*. 1979. "European Data Production Chiefs to Meet in Bonn." March 1: 1

<sup>5</sup> The International Working Group on Data Protection in Telecommunications (IWGDP) was established in 1983 under the auspices of the International Conference of Data Protection Commissioners. It meets biannually and is comprised of data protection organizations and invites participation from industry and independent specialists. The group's work is available at <http://www.datenschutz-berlin.de/doc/int/iwgdpt/index.htm>.

<sup>6</sup> For the position of the transgovernmental network see *Transnational Data and Communications Report*. 1990. "Data Protection Essential to EC 1992." May 5-10.

<sup>7</sup> For the political history of the directive see (Newman 2005). Council of the European Union and the Parliament 95/46/EC, 1995 O.J. (L 281) 31, *The Directive on the protection of individuals with regard to the processing of personal data and on the free movement of such data*. For a description of the political history behind the directive see (Simitis 1995), (Newman 2005).

<sup>8</sup> The opinions and recommendations of the Article 29 Working Party can be found at [http://europa.eu.int/comm/justice\\_home/fsj/privacy/workinggroup/index\\_en.htm](http://europa.eu.int/comm/justice_home/fsj/privacy/workinggroup/index_en.htm).

<sup>9</sup> Energy policy has thus been considered as “one of the weakest policy areas of the EU” (Matlary 1997, 13). The key reason is that member states have been keen to keep tight control over a sector they consider of strategic economic importance (Padgett 1992).

<sup>10</sup> The Directive had only required member states to “create appropriate and efficient mechanisms for regulation, control and transparency so as to avoid any abuse of a dominant position” (Art. 22).

<sup>11</sup> 2003/54/EC Electricity and 2003/55/EC Gas.

<sup>12</sup> Article 23, Directive 2003/54/EC (electricity) and Article 25, Directive 2003/55/EC (gas).

<sup>13</sup> The official terms are “European Electricity Regulation Forum” and “European Gas Regulatory Form”, Florence and Madrid are the two cities where the two Fora began to meet. For details on the Forum processes see (Eberlein 2005).

<sup>14</sup> Regulation (EC) No 1228/2003 of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity; Regulation (EC) 1775/2005 on access conditions to the gas transmission networks.

<sup>15</sup> In 2003 CEER adopted the status of a not-for-profit association under Belgian Law. For details see [www.ceer-eu.org](http://www.ceer-eu.org).

<sup>16</sup> Commission Decision of 11 November 2003 on establishing the European Regulators Group for Electricity and Gas (2003/796/EC).

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<sup>17</sup> See ERGEG Work Programme 2006, page 3, footnote 1, available at <http://www.ergeg.org>. In essence, the establishment of the ERGEG formalizes the informal regulatory role played by CEER in the Forum Process. To be sure, the CEER remains a distinct body with a slightly broader membership base (not restricted to EU Member States). And it does play a larger role, for example, in international networking and in providing training courses for regulators through the “Florence School of Regulation”. Yet, it is quite clear, that, in terms of activities and leadership in the EU context, there is broad overlap between the ERGEG and the CEER. It is indicative that ERGEG is housed at the CEER Secretariat in Brussels.

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