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## Interjurisdictional Competition Within the European Union

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# Interjurisdictional Competition Within the European Union

Wolfgang Kerber

## **Abstract**

Part I of this Essay shows that two central principles of the EC, namely mobility between Member States and decentralization of economic policies (subsidiarity), imply that Member States and other lower-level jurisdictions necessarily are in competition with one another (locational competition). Part II presents an outline of a theory of interjurisdictional competition that suggests, first, that only a competitive system of jurisdictions can be compatible with both decentralization and mobility and, second, that interjurisdictional competition may be a superior way of supplying public goods and services. Part III argues that the institutional structure of the EC has failed to take into account the dimension of locational competition among jurisdictions, thus leading to an often unwanted tendency to centralization. Alternatively, Part III suggests an integrated set of rules for competition that protects both competition among firms and interjurisdictional competition within the Community.

# V. THE DEREGULATION OF GLOBALIZING MARKETS

## INTERJURISDICTIONAL COMPETITION WITHIN THE EUROPEAN UNION

*Professor Dr. Wolfgang Kerber\**

### INTRODUCTION

The tensions between the additional shifting of competences for economic policies from the Member States level to the European Community ("EC" or "Community") level, and increasing desires of the EC population for decentralization and preservation of regional diversity, both seem to grow. The debate on the principle of subsidiarity shows their growth. The approaching enlargement of the Community will increase the heterogeneity of the Member States and further aggravate this problem. The question therefore arises, how can the institutional structures of the EC be reformed in a way that both the Community's central aim of an internal market, and decentralization and diversity within the EC, are simultaneously achieved?

It is not possible to suggest an elaborated answer in this Essay, but the following reason should call attention to an important dimension of this problem, which up until now seems to have been neglected: competition among jurisdictions. Part I of this Essay shows that two central principles of the EC, namely mobility between Member States and decentralization of economic policies (subsidiarity), imply that Member States and other lower-level jurisdictions necessarily are in competition with one another (locational competition). Part II presents an outline of a theory of interjurisdictional competition that suggests, first, that only a competitive system of jurisdictions can be compatible with both decentralization and mobility and, second, that interjurisdictional competition may be a superior way of supplying public goods and services. Part III argues that the institutional structure of the EC has failed to take into account the dimension of locational competition among jurisdictions, thus

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leading to an often unwanted tendency to centralization. Alternatively, Part III suggests an integrated set of rules for competition that protects both competition among firms and interjurisdictional competition within the Community.

### I. THE PROBLEM: DECENTRALIZATION + MOBILITY = INTERJURISDICTIONAL COMPETITION

The EC Member States still have many competences regarding economic policies, but in the last several years there has been a clear tendency toward a growing centralization. The European Monetary Union will even further strengthen centralization. The problem of increasing centralization within the EC is one of the most debated issues of European integration. The respective dangers seem to be bureaucratization, rent-seeking through lobbyism on the EC level, and failing responsiveness to the preferences of the constituents.<sup>1</sup> The concerns about this development have led to the introduction of the principle of subsidiarity in the Maastricht Treaty,<sup>2</sup> and are stressed again in the Treaty of Amsterdam.<sup>3</sup> Consequently, the process of Euro-

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1. See, e.g., BRUNO S. FREY, EIN NEUER FÖDERALISMUS FÜR EUROPA: DIE IDEE DER FOCJ (1997); Roland Vaubel, *The Centralisation of Western Europe: The Common Market, Political Integration, and Democracy*, Institute of Economic Affairs, Hobart Paper, 127 (1995).

2. Treaty on European Union, Feb. 7, 1992, O.J. C 224/1 (1992), [1992] 1 C.M.L.R. 719, [hereinafter TEU] (amending Treaty establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11, [hereinafter EEC Treaty] as amended by Single European Act, O.J. L 169/1 (1987), [1987] 2 C.M.L.R. 741 [hereinafter SEA]).

3. See Protocol on the Application of the Principles of Subsidiarity and Proportionality in the Treaty of Amsterdam amending the TEU, the Treaties establishing the European Communities and certain related acts, Oct. 2, 1997, art. 12, O.J. C 340/1, at 78-79 (1997) (not yet ratified) [hereinafter Treaty of Amsterdam]. See also C. KOENIG & A. HARATSCH, *EUROPARECHT* 26 (2d ed. 1998). For a discussion on the importance of the principle of subsidiarity for the institutional structure of the European Community ("EC" or "Community") from a legal or economic perspective, see Nicolas Bernard, *The Future of European Economic Law in the Light of the Principle of Subsidiarity*, 33 COMMON MKT. L. REV. 633 (1996); Nicholas Emiliou, *Subsidiarity: Panacea or Fig Leaf?*, in LEGAL ISSUES OF THE MAASTRICHT TREATY 65 (David O'Keeffe & Patrick M. Twomey eds., 1994); Karl Homann & Christian Kirchner, *Das Subsidiaritätsprinzip in der Katholischen Soziallehre und in der Ökonomie*, in EUROPA ZWISCHEN ORDNUNGSWETTBEWERB UND HARMONISIERUNG: EUROPÄISCHE ORDNUNGSPOLITIK IM ZEICHEN DER SUBSIDIARITÄT 45 (L. Gerkin ed., 1995); Christian Kirchner, *The Principle of Subsidiarity, in the Treaty on European Union: A Critique from a Perspective of Constitutional Economics*, 6 TUL. J. INT'L & COMP. L. 291 (1998) [hereinafter Kirchner I]; Christian Kirchner, *Europäisches Vertragsrecht*, in EUROPÄISCHES VERTRAGSRECHT 103 (H.L. Weyes ed., 1997) [hereinafter Kirchner II]; Christian Kirchner, *Competence Catalogues and the Principle of Subsidiarity in a Euro-*

pean integration now seems to be explicitly linked to the idea that decentralization should be preserved as far as possible.

Whereas the decentralization issue is rather new and still controversial, the facilitation of mobility between the Member States has been a longstanding central aim of the EC. The removal of all obstacles to the free flow of goods, services, persons, and capital has been the basic thrust of the program for the completion of the Internal Market, which has been realized step by step since the 1980s. Because the original idea of removing all non-tariff barriers to trade within the EC through harmonization could not be carried out, the concept of "mutual recognition,"<sup>4</sup> has been applied to many national regulations, which previously impeded the free movement of goods, services, persons, and capital. Without discussing the highly differentiated and complex outcome of this development, including the various provisions of the Member States, most existing barriers have been torn down, leading to a sharp increase in the mobility of individuals, firms, goods, services, and production factors within the EC.<sup>5</sup> Rapid technical progress in transport and communication technologies has also increased their mobility.

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*pean Constitution*, in 8 CONST. POL. ECON. 71 (1997) [hereinafter Kirchner III]; Wernhard Möschel, *Zum Subsidiaritätsprinzip im Vertrag von Maastricht*, 47 NEUE JURISTISCHE WOCHENSCHRIFT 3025 (1993); Mathias Rohe, *Binnenmarkt oder Interessenverband? Zum Verhältnis von Binnenmarktziel und Subsidiaritätsprinzip nach dem Maastricht-Vertrag*, 61 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT 1 (1997); Hans-Werner Sinn, *How Much Europe? Subsidiarity, Centralization and Fiscal Competition*, 41 SCOT. J. POL. ECON. 85 (1994); Josephine Steiner, *Subsidiarity Under the Maastricht Treaty*, in LEGAL ISSUES OF THE MAASTRICHT TREATY 49 (David O'Keeffe & Patrick M. Twomey eds., 1994); Akos G. Toth, *The Principle of Subsidiarity in the Maastricht Treaty*, 29 COMMON MKT. L. REV. 1079 (1992). For an example of how economic criteria can be used to apply the subsidiarity principle in the EC for competition policy, see Roger Van den Bergh, *Economic Criteria for Applying the Subsidiarity Principle in the European Community: The Case of Competition Policy*, 16 INT'L REV. L. & ECON. 363 (1996).

4. The European Court of Justice developed the concept of mutual recognition, or principle of origin, in the famous "Cassis de Dijon" decision. *Rewe v. Bundesmonopolverwaltung für Branntwein*, Case 120/78, [1979] E.C.R. 649, [1979] 3 C.M.L.R. 494. The development continued in the Commission's White Paper on the Internal Market.

5. See generally JAMES D. DINNAGE & JOHN F. MURPHY, *THE CONSTITUTIONAL LAW OF THE EUROPEAN UNION* 430 (1996); Rohe, *supra* note 3, at 12; Piet Jan Slot, *Harmonisation*, 21 EUR. L. REV. 378 (1996); Manfred E. Streit & Werner Mussler, *The Economic Constitution of the European Community—From "Rome" to "Maastricht"*, 5 CONST. POL. ECON. 319 (1994); Stephen Weatherill & Paul Beaumont, *EC LAW* 490 (2d ed. 1995). For a recent account of the state of the internal market, see Kamiel Mortelsman, *The Common Market, the Internal Market and the Single Market, What's in a Market?*, 35 COMMON MKT. L. REV. 101 (1998).

As a consequence of enhanced mobility, competition among firms within the EC has intensified considerably, i.e., many previously national markets have turned into European markets in which firms from different Member States compete with one another. More important, not only goods and services, but also individuals, firms, and capital can move much more freely between Member States while looking for the most attractive location for their investments. From an economic perspective, the free movement of individuals, firms, and capital can be seen as leading to the efficient spatial allocation of resources such that all factors of production move to the locations of their highest productivity. This kind of mobility implies that the different locations in the EC, and therefore the respective Member states, regions,<sup>6</sup> and municipalities as well, must be viewed as being in competition with one another because the influx of resources usually has wealth-enhancing effects leading to more jobs and an extension of the tax base.

The attraction of territorially defined state units, or "jurisdictions," for mobile individuals, firms, and productive resources, and hence their competitiveness, depends on many determinants. Although the requirements for locations differ among the firms and their respective type of production, the following determinants may be relevant: natural conditions, law, regulations, bureaucracy, taxes, infrastructure, political stability, human capital of the workforce, wages, etc. Consequently, the competitiveness of locations not only depends on natural conditions, but also to a large degree on the economic policies of the jurisdictions themselves. An extensive and well-maintained infrastructure in the form of motorways and airports can be as important an advantage for firms as is a well-educated, competent workforce or a flexible bureaucracy that does not block investments by a narrow-minded application of regulations. Since economic policies of jurisdictions can influence the competitiveness of their territory as a location for mobile individuals, firms, and factors of production, the jurisdictions compete with one another with respect to their policies, especially for the attraction of new firms/new investments.

This kind of competition among Member States, regions, or

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6. A region is an area undefined by national boundaries. For example, Bundesländer is a region in Germany and Austria.

municipalities can be observed in many ways. One form is the bidding of jurisdictions for the establishment of new firms by offering subsidies or other specific advantages to the firms, which would be a case for state aid policy by the Commission. But there are many other forms as well. Any economic policy that tries to improve the locational conditions of the jurisdiction must be seen in the context of these competition processes. Deregulation, the extension of infrastructure, the improvement of the performance of the public sector or the legal system, investments in universities and scientific research, and reductions in taxes, are measures that can improve the competitiveness of the respective jurisdiction. Consequently, the increasing mobility, which has been facilitated by removing the barriers to the free movement of goods, services, persons, and capital, has led not only to an increasing competition among firms, but also to considerable competition among Member States, regions, and municipalities within the European Union.

How do the competition processes among jurisdictions fit into the overall concept of European integration? Our contention is that up until now they are not seen as being an integral part of the process of European integration, although nobody would deny the existence of such a competition. It seems rather that advocates of European integration have a hostile attitude toward the idea of competition among jurisdictions. But here we want to call attention to the conclusion that if we do not want this competition, then only two main strategies remain for its elimination. The first strategy would be the reduction of mobility through the reestablishment of obstacles to mobility. But the tearing down of these barriers and the creation of an internal market in the EC has been one of the central ideas of European integration. The second strategy would consist of eliminating the decentralized competences of Member States, regions, and municipalities to decide freely on their economic policies, because through either harmonization, i.e., cartelization, or centralization of economic policies, the jurisdictions would lose their instruments for competing with one another. But this strategy would deny the possibility of decentralization as a second central principle of European integration. The core of the problem is that *simultaneous realization of mobility and decentralization logically implies the existence of competition among jurisdictions.*

## II. A NEW APPROACH: COMPETITION AMONG JURISDICTIONS

### A. Introduction

Competition among jurisdictions, or interjurisdictional competition, can be seen as a new theoretical approach that analyzes the competition processes among territorially defined units such as states, regions, and municipalities. Older roots of this approach are Charles Tiebout's market solution for the provision of local public goods<sup>7</sup> and the economic theory of federalism, especially new developments such as competitive federalism.<sup>8</sup> With regard to the problems of European integration, globalization, and locational competition, interjurisdictional competition has been discussed under different headings, such as "systems competition," "institutional competition," "locational competition," or "competition among governments."<sup>9</sup> Despite

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7. Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

8. See ALBERT BRETON, *COMPETITIVE GOVERNMENTS: AN ECONOMIC THEORY OF POLITICS AND PUBLIC FINANCE* (1996) [hereinafter Breton I]; Albert Breton, *Towards a Theory of Competitive Federalism*, 3 EUR. J. POL. ECON. 263 (1987) [hereinafter Breton II]; THOMAS R. DYE, *AMERICAN FEDERALISM: COMPETITION AMONG GOVERNMENTS* (1990); *COMPETITION AMONG STATES AND LOCAL GOVERNMENTS: EFFICIENCY AND EQUITY IN AMERICAN FEDERALISM* (Daphne A. Kenyon & John Kincaid eds., 1991).

9. See William W. Bratton & Joseph A. McCahery, *The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World*, 86 GEO. L.J. 201 (1997); Breton I, *supra* note 8; Breton II, *supra* note 8; DYE, *supra* note 8; Bruno S. Frey & Reiner Eichenberger, *Competition Among Jurisdictions: The Idea of FOCJ*, in *COMPETITION AMONG INSTITUTIONS* 209 (L. Gerken ed., 1995); FREY, *supra* note 1; Konstantine Gatsios & P. Holmes, *Regulatory Competition*, in 3 *THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW* 271 (P. Newman ed., 1998); H. Hauser & M. Hösli, *Harmonization or Regulatory Competition in the European Community*, 46 *AUSSENWIRTSCHAFT* 497 (1991); Kenyon & Kincaid, *supra* note 8; Wolfgang Kerber, *Zum Problem einer Wettbewerbsordnung für den Systemwettbewerb*, 17 *JAHRBUCH FÜR NEUE POLITISCHE ÖKONOMIE* 199 (1998) [hereinafter *Zum Problem*]; Wolfgang Kerber, *Erfordern Globalisierung und Standortwettbewerb einen Paradigmenwechsel in der Theorie der Wirtschaftspolitik?* in 49 *ORDO* 253 (1998) [hereinafter *Erfordern Globalisierung*]; Wallace E. Oates, *Environmental Policy in the European Community: Harmonization or National Standards*, 25 *EMPIRICA* 1 (1998); Wallace E. Oates & Robert M. Schwab, *Economic Competition Among Jurisdictions: Efficiency Enhancing or Distortion Inducing?*, 35 J. PUB. ECON. 333 (1988); *LOCATIONAL COMPETITION IN THE WORLD ECONOMY* (Horst Siebert ed., 1995); Horst Siebert & Michael J. Koop, *Institutional Competition: A Concept for Europe?*, 45 *AUSSENWIRTSCHAFT* 462 (1990); Hans-Werner Sinn, *The Limits to Competition Between Economic Regimes*, in 17 *EMPIRICA—AUSTRIAN ECONOMIC PAPERS* 3 (1990) [hereinafter *Limits to Competition*]; Sinn, *supra* note 3; Hans-Werner Sinn, *Implikationen der vier Grundfreiheiten für eine nationale Fiskalpolitik*, in *WIRTSCHAFTSDIENST* 240 (1995); Hans-Werner Sinn, *The Selection Principle and Market Failure in Systems Competition (MS)*, in *Journal of Public Economics* (forthcoming 1997) [hereinafter *Selection Princi-*



rapidly expanding literature on these rather heterogeneous approaches, they are still barely elaborated on, both on theoretical and empirical grounds.<sup>10</sup> The common basic idea is that the increasing mobility of individuals, firms, and capital may allow the market approach also to be applied to the provision of institutions and other public goods and services throughout jurisdictions.

From the individualistic perspective of Constitutional Economics, the normative point of reference is the voluntary consent of individuals<sup>11</sup> and therefore the fulfillment of their preferences. Since not all problems can be solved by private production (private goods), agencies with coercive power are necessary to overcome prisoners' dilemmas in the provision of public goods.<sup>12</sup> But how can it be ensured that the activities of such a state as a monopolist will fulfill the preferences of its constituents? Since the political system works imperfectly in controlling governments, rent-seeking problems (public choice) and knowledge problems have been elaborated as central problems of economic policy, leading to the recommendation of limiting the power of government by constitutional constraints and restricting economic policy to the rule of law.<sup>13</sup> An alternative approach, which can be seen as complementary to these proposals, is the idea that competition among states can help both to confine the discretionary power of governments and to alleviate the knowledge problem by directing their activities to a better fulfillment of individuals' preferences.

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*ple and Market Failure*]; Stefan Sinn, *The Taming of Leviathan: Competition Among Governments*, 3 CONST. POL. ECON. 172 (1992).

10. Extensive theoretical and empirical literature exists in the tradition of the Tiebout model. For a survey of this literature, see Keith Dowding, Peter John, & Stephen Biggs, *Tiebout: A Survey of the Empirical Literature*, 31 URB. STUD. 767 (1994). But this discussion has taken place in the special institutional conditions of the United States. The new approach must be seen as considerably broader. First, not only are public goods being taken into account, but also law and regulations are as well. Second, competition is not only seen in neo-classical equilibrium thinking, but also as an innovative experimentation process. The traditional Tiebout approach, therefore, seems to be too narrow for analyzing problems that emerge in the context of European integration.

11. James M. Buchanan, *The Constitution of Economic Policy*, 77 AM. ECON. REV. 243 (1986).

12. JAMES M. BUCHANAN, *THE LIMITS OF LIBERTY: BETWEEN ANARCHY AND LEVIATHAN* (1975).

13. *Id.*; 3 FRIEDRICH A. HAYEK, *LAW, LEGISLATION, AND LIBERTY: THE POLITICAL ORDER OF A FREE PEOPLE* (1979).

### B. *Applying the Market Approach to Interjurisdictional Competition*

The market analogy can be applied as follows.<sup>14</sup> The jurisdictions correspond to the firms in normal markets. They are the organizations that compete with one another. The governments of the jurisdictions can be compared with the management of firms. They are the agents who should make decisions in the interest of their principals, including constituents and capital owners. The products or services of the firms that are traded on normal markets correspond to the public goods and services that are provided by the jurisdictions. The latter consists of infrastructure, the legal system, regulations, social security systems, and all other forms of economic policies. Instead of prices, as in normal markets, taxes must be paid. Jurisdictions, therefore, can be said to compete with complex bundles of public goods, services, and taxes. Crucial for creating markets for public goods/taxes bundles are, first, the right of jurisdictions to decide on the content of their bundle and, second, the mobility of individuals, firms, and factors of production between jurisdictions that allows them to choose between different bundles offered by various jurisdictions. If jurisdictions are seen as territorial multi-product clubs, including club memberships linked with rights and duties, then the choices of individuals or firms between different jurisdictions can also be understood as exit and entry decisions, and the competition processes as competition among clubs.

The working of competition processes among jurisdictions can also be analogized to competition among firms in ordinary markets. Based upon an evolutionary approach to competition that draws on the basic ideas of Joseph Schumpeter<sup>15</sup> and Friedrich Hayek,<sup>16</sup> competition is seen as a rivaling process in which competitors are constantly searching for better solutions for their customers' problems.<sup>17</sup> It is important to note that from an

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14. For a more detailed application of the market analogy, see *Zum Problem*, *supra* note 9.

15. JOSEPH A. SCHUMPETER, *THEORIE DER WIRTSCHAFTLICHEN ENTWICKLUNG*, 5. Aufl. (Duncker & Humblot 1912) (discussing competition as innovation process).

16. Friedrich A. Hayek, *Competition as a Discovery Procedure*, in *NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS AND THE HISTORY OF IDEAS* 179 (Friedrich A. Hayek ed., 1978).

17. For a discussion on the concept of evolutionary competition that tries to integrate Schumpeterian and Hayekian notions of competition with evolutionary variation-selection processes, see Wolfgang Kerber, *Wettbewerb als Hypothesentest: Eine evolutorische*

evolutionary perspective, the governments of the jurisdictions have no certain knowledge about the best economic policies to fulfill their customers' preferences as an attractive location. This situation is known as Hayek's knowledge problem.<sup>18</sup> Just as firms must experiment with different products and technologies to find out how they can solve their customers' problems as good/cheap as possible, jurisdictions also must try different bundles of public goods, services, and taxes to attract individuals, firms, or capital. Jurisdictions that offer more attractive bundles than their competitors, or produce their public goods and services more efficiently, would win a competitive advantage leading to an influx of resources. At the same time, their less successful competitors would fall back and lose investments, thus implying incentives to improve their performance such as by learning from the better economic policies of their competitors, or imitation.<sup>19</sup>

Consequently, locational competition among jurisdictions may be understood as a constant process of parallel experimentation with economic policies such as new institutional arrangements. In this process, new knowledge is generated and spread by mutually learning how jurisdictions can improve their bundles of public goods, services, and taxes in reference to their customers' problems.<sup>20</sup> Potential advantages of competition

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*Konzeption wissenschaftenden Wettbewerbs, in DIMENSIONEN DES WETTBEWERBS: SEINE ROLLE IN DER ENTSTEHUNG UND AUSGESTALTUNG VON WIRTSCHAFTSORDNUNGEN* 29 (K. Delhaes & U. Fehl eds., 1997). See also Viktor Vanberg & Wolfgang Kerber, *Institutional Competition among Jurisdictions: An Evolutionary Approach*, 5 CONST. POL. ECON. 193 (1994) (regarding competition among jurisdictions). In this approach, competition is understood as a process in which new knowledge is being generated and spread, i.e. innovation-imitation-processes.

18. The Hayekian knowledge problem is crucial for understanding the advantages of competition and the importance of decentralization. For an elaboration of this problem and the consequences for economic policy, see Friedrich A. Hayek, *Die Irrtümer des Konstruktivismus und die Grundlagen legitimer Kritik gesellschaftlicher Gebilde, reprinted in DIE ANMAßUNG VON WISSEN. NEUE FREIBURGER STUDIEN* 16 (Wolfgang Kerber ed., 1970); Manfred E. Streit, *Cognition, Competition, and Catallaxy. In Memory of Friedrich August von Hayek*, 4 CONST. POL. ECON. 223 (1993); Viktor Vanberg & James M. Buchanan, *Constitutional Choice, Rational Ignorance and the Limits of Reason*, in 10 JAHRBUCH FÜR NEUE POLITISCHE ÖKONOMIE 61 (1991).

19. An important problem is how the political institutions within jurisdictions have to be designed to ensure the appropriate incentives for politicians. This problem will not be discussed in this Essay.

20. Frey & Eichenberger, *supra* note 9; Manfred E. Streit, *Systemwettbewerb im europäischen Integrationsprozeß*, in FESTSCHRIFT FÜR ERNST-JOACHIM MESTMÄCKER: ZUM

processes among jurisdictions may not only be the generation of innovations in the sphere of public goods and services, but also the control of the power of governments. It has been suggested that interjurisdictional competition may also help to solve rent-seeking problems<sup>21</sup> because losers of rent-seeking games are able to leave their respective jurisdictions and choose jurisdictions with less rent-seeking.<sup>22</sup> An important advantage in contrast to collective decisions about economic policies in the political system of jurisdictions may be the lack of "rational ignorance" because individual choice between different bundles of jurisdictions maintains the incentives to invest in information about different jurisdictions' offers. Individuals, therefore, directly control the performance of jurisdictions regarding the fulfillment of their preferences, a concept known as voting by feet.

### C. *Problems of Market Failure*

The basic problem is how to ensure that competition processes are working in a manner such that the results of interjurisdictional competition are really fulfilling the individuals' preferences so as to avoid market failure. Since many kinds of market failure might exist in ordinary markets, it is not surprising that an extensive discussion has developed about potential failures of competitive processes among jurisdictions, thus leading to a wide spectrum of opinions about the feasibility of these competition processes.<sup>23</sup>

One of the central problems is determining whether interjurisdictional competition, with regard to regulations, would lead to a "race to the bottom." A race to the bottom is a competition process among regulations in which only the lowest stan-

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SIEBZIGSTEN GEBURTSTAG 521 (U. Immenga, W. Möschel, & D. Reuter eds., 1996); Vanberg & Kerber, *supra* note 17.

21. Stefan Sinn, *supra* note 9.

22. Viktor Vanberg, *Systemtransformation, Ordnungsevolution und Protektion: Zum Problem der Anpassung von Wirtschaftssystemen an ihre Umwelt*, in INSTITUTIONELLE PROBLEME DER SYSTEMTRANSFORMATION 11 (D. Cassel ed., 1997).

23. See Bratton & McCahery, *supra* note 9; Breton I, *supra* note 8; Breton II, *supra* note 8; DYE, *supra* note 8; Frey & Eichenberger, *supra* note 9; FREY, *supra* note 1; Gatsios & Holmes, *supra* note 9; Hauser & Hösli, *supra* note 9; Kenyon & Kincaid, *supra* note 8; *Zum Problem*, *supra* note 9; *Erfordern Globalisierung*, *supra* note 9; Oates, *supra* note 9; Oates & Schwab, *supra* note 9; LOCALATIONAL COMPETITION IN THE WORLD ECONOMY (Horst Siebert ed., 1995); Siebert & Koop, *supra* note 9; *Limits to Competition*, *supra* note 9; Sinn, *supra* note 3; Hans-Werner Sinn, *supra* note 9; *Selection Principle and Market Failure*, *supra* note 9; Stefan Sinn, *supra* note 9.

dards survive, and would not fulfill the preferences of the individuals.<sup>24</sup> It has been argued that regulatory competition, which should solve problems of adverse selection, can itself suffer from problems of adverse selection, thus leading to inefficient low regulations.<sup>25</sup> But in discussions regarding the so-called "Delaware effect," it is highly disputed whether competition among corporate laws of different U.S. states has led to an inefficient low degree of regulation or, as more recent studies suggest, to a constant process of institutional innovations that must be assessed positively.<sup>26</sup> Other studies about regulatory competition also found that a "race to the top" exists.<sup>27</sup> Although it seems that there does not need to be a race to the bottom, the question of whether the regulations that survive in competition processes among jurisdictions are really the superior regulations in terms of the individuals' preferences is very important, and cannot be answered without further extensive research.

A difficult problem that has extensive literature is determining whether tax competition leads to efficient outcomes or results in predatory competition. It has been contended that tax competition under certain conditions might lead to an underprovision of public goods and/or too low a degree of redistribution.<sup>28</sup> Depending on the type of taxes and other assumptions of the models, very different results can be deduced, thus exemplifying the complexity of this problem.<sup>29</sup>

24. See generally Gatsios & Holmes, *supra* note 9; Hauser & Hösli, *supra* note 9; Horst Siebert, *The Harmonization Issue in Europe: Prior Agreement or Competitive Process?*, in *THE COMPLETION OF THE INTERNAL MARKET* 53-75 (Horst Sievert ed., 1990); Siebert & Koop, *supra* note 9; Jeanne-Mey Sun & Jacques Pelkmans, *Regulatory Competition in the Single Market*, 33 J. COMMON MKT. STUD. 67 (1995); STEPHEN WOOLCOCK, *THE SINGLE EUROPEAN MARKET: CENTRALIZATION OR COMPETITION AMONG NATIONAL RULES* (1994).

25. *Limits to Competition*, *supra* note 9; *Selection Principle and Market Failure*, *supra* note 9.

26. William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974); Hanno Merkt, *Das Europäische Gesellschaftsrecht und die Idee des "Wettbewerbs der Gesetzgeber"*, 59 RABELSZ 545 (1995); Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709 (1987); Roberta Romano, *Competition for State Corporation Law*, in 1 *THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW* 364 (P. Newman ed., 1998).

27. This is known as the "California effect." See Philipp Genschel & T. Plümper, *Regulatory Competition and International Co-operation*, 4 J. EUR. PUB. POL'Y 4, 626 (1997); DAVID VOGEL, *TRADING UP: CONSUMER AND ENVIRONMENTAL REGULATION IN A GLOBAL ECONOMY* (1995).

28. *Limits to Competition*, *supra* note 9.

29. See, e.g., Hans-Werner Sinn, *Tax Harmonization and Tax Competition in Europe*, 34

Free migration can lead to problems for the competing jurisdictions' redistribution policies through effects of adverse selection.<sup>30</sup> Other problems can be the existence of technological external effects that might lead to inefficient outcomes if they transcend the boundaries of the respective jurisdictions (spillovers).<sup>31</sup> Additionally, the problem of restraints of interjurisdictional competition, through harmonization (i.e., cartelization) or centralization of certain tasks, for example, must be taken into account.<sup>32</sup> An especially difficult problem is mobility itself because exit costs can be different and can lead to the possibility of immobile individuals who might not be able to gain from the advantages of competition processes among jurisdictions.

#### D. *A Framework of Rules for Interjurisdictional Competition*

Applying the market approach to jurisdictions results in many problems that cannot be deemed negligible. The question is determining which conclusions to draw from potential market failures. At first sight, it seems that problems of interjurisdictional competition might lead to the conclusion that the idea of applying the market approach to jurisdictions might itself be wrong. This conclusion, however, would imply either giving up mobility between jurisdictions or eliminating decentralization. And from a methodological point of view, the choice is not limited to the alternatives of competition or non-competition, respectively decentralization or centralization/harmonization. Rather, the adequate strategy is to ask whether an institutional framework might exist for those competition processes that help avoid problems of market failure. This conclusion stems from a central hypothesis of institutional economics<sup>33</sup> that most market failures have their causes in inadequate institutional arrange-

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EUR. ECON. REV. 489 (1990); A. Wagener, *INTERNATIONALER STEUERWETTBEWERB MIT KAPITALSTEUERN* (1997); David E. Wildasin, *Interjurisdictional Capital Mobility: Fiscal Externalities and a Corrective Subsidy*, 25 J. URB. ECON. 193 (1989); George R. Zodrow & Peter Mieszkowski, *Pigou, Tiebout, Property Taxation, and the Underprovision of Local Public Goods*, 19 J. URB. ECON. 356 (1986).

30. A. Dercks, *Redistributionspolitik und föderale Ordnung*, Köln (1996); *Limits to Competition*, *supra* note 9.

31. Ngo van Long & Horst Siebert, *Institutional Competition Versus ex-ante Harmonization: The Case of Environmental Policy*, 147 J. INST. & THEOR. ECON. 296 (1991).

32. Vanberg & Kerber, *supra* note 17, at 215.

33. The property rights theory is an example of a central hypothesis of institutional economics.

ments and hence can be eliminated, or at least alleviated, by a better specification of property rights. The next step, therefore, should be to look for rules for interjurisdictional competition that help solve the various problems of potential market failure. The question of whether the market approach must be abandoned should only arise if there is no set of rules that solves the emerging problems.

But even if designing adequate institutional arrangements cannot eliminate all inefficiencies, the conclusion to abandon decentralization or mobility is still not reached. A comparative institution approach,<sup>34</sup> in which the costs of market failure are weighed against the costs of all problems linked to centralization or abandonment of mobility, should instead be applied. Since experience shows that collective decision-making implies large costs such as knowledge, rent-seeking problems, inefficiencies, or inflexibility, it might be that considerable costs through market failure must also be accepted before it is advisable to turn to centralization or mobility barriers. The necessary and promising research strategy therefore lies in applying a comparative institution approach in searching for appropriate sets of rules that channel the competition processes among jurisdictions toward a better fulfillment of individuals' preferences. These considerations strongly suggest that as normal markets need an underlying institutional structure with property rights and competition rules, markets for public goods and services also need a framework of rules that jurisdictions must observe.<sup>35</sup>

In the following Section, it is impossible to show how such a framework of rules should look. The various problems are too difficult to discuss briefly, and for most problems a lot of research is still necessary before reliable answers are possible. But the basic idea of the market approach to jurisdictions cannot be understood properly if the concept of interjurisdictional competition is not outlined as a concept that implies a multi-level system of jurisdictions and therefore also draws on important insights of the economic theory of fiscal federalism.<sup>36</sup>

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34. Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1 (1969).

35. See, e.g., Siebert & Koop, *supra* note 9, at 455; Vanberg & Kerber, *supra* note 17, at 280.

36. See generally FÖDERALISMUS (G. Kirsch, ed. 1977); RICHARD M. BIRD, FEDERAL FINANCE IN COMPARATIVE PERSPECTIVE (Can. Tax Found., 1986); Breton I, *supra* note 8;

E. *A Multi-Level System of Competing Jurisdictions and the Problem of the Vertical Allocation of Competences*

Since the benefits of public goods spread differently locally, regionally, nationally, or beyond, the existence of a differentiated multi-level system of jurisdictions, such as municipalities, regions, EC Member States, and the EC, seems necessary. The theory of fiscal federalism developed a set of criteria for the vertical assignment of competences to various levels of a federal multi-level system of jurisdictions, including spillover effects, economies of scale, heterogeneity of preferences, and transaction costs.<sup>37</sup> Within such a system, the jurisdictions on all levels compete with their competitors on the same level, with the exception of the top level. Since the vertical assignment of competences determines which problems must be solved on the respective levels of jurisdictions, it also defines which economic policies the jurisdictions can use in their competition with other jurisdictions on these levels. In such a multi-level system of jurisdictions, parallel experimentation processes to improve the performance of the jurisdictions take place simultaneously on all levels.<sup>38</sup> An important precondition for such a system to work is the observance of the principle of fiscal equivalence,<sup>39</sup> which also implies that jurisdictions on all levels have the competence for taxation to decide their revenues and expenditures themselves.

Shifting competences from higher to lower levels in a hierarchical system of jurisdictions has considerable impact on the extent of competition within such a system. If a certain task is shifted from the national level to a lower level, such as regions or municipalities, then additional competitive processes among territorial sub-units concerning finding better ways to fulfill the task are possible. If, conversely, competences are shifted upwards, then the advantage of experimenting for better solutions is discarded. Because of the additional knowledge-creating effect of competition as a "discovery procedure," another argument for further decentralization in federally-organized jurisdictions can

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Breton II, *supra* note 8; DYE, *supra* note 8; WALLACE E. OATES, *FISCAL FEDERALISM* (1972).

37. OATES, *supra* note 36; Breton I, *supra* note 8, at 184.

38. *Zum Problem*, *supra* note 9.

39. Mancur Olson, Jr., *Strategic Theory and Its Applications—The Principle of "Fiscal Equivalence": The Division of Responsibilities Among Different Levels of Government*, 59 *AM. ECON. REV.* 479 (1969).



be derived that goes even beyond the above mentioned criteria of fiscal federalism.<sup>40</sup> The more decentralized such a system of jurisdictions is, the greater the openness of the system for experimentation with bundles of public goods, services, and taxes, and the lower the risk of getting stuck with wrong economic policies because errors tend to be corrected more easily. Since these experimentation processes are controlled by interjurisdictional competition, a constant stream of innovative improvements of institutions and other economic policies can be expected.<sup>41</sup> Centralization of competences, however, would eliminate knowledge-creating competition processes and ultimately lead to centralized decisions about presumably homogeneous bundles of public goods and services throughout all jurisdictions. It can be expected that both the regional heterogeneity of preferences and local knowledge about specific problems and their adequate solutions will be neglected because knowledge on the central level will necessarily be limited.<sup>42</sup>

Since the institutional structure of such a system of jurisdictions must be viewed in the long run, another important dimension must be taken into account.<sup>43</sup> Deduced from the criteria of the economic theory of federalism, including the knowledge-creating effect of experimentation, it might be conceivable to find an optimal structure of jurisdictions with an appropriate assign-

40. Wolfgang Kerber & Viktor Vanberg, *Competition Among Institutions: Evolution Within Constraints*, in COMPETITION AMONG INSTITUTIONS 35, 47 (L. Gerken ed., 1995); Martti Vihanto, *Competition Between Local Governments as a Discovery Procedure*, 148 J. INST. & THEORETICAL ECON. 411, 415 (1992).

41. Legal scholars have also stressed the positive effects of experimentation processes in the sphere of law, and have elaborated the potential dangers of uniformity of law through harmonization. See, e.g., Peter Behrens, *Voraussetzungen und Grenzen der Rechtsfortbildung durch Rechtsvereinheitlichung*, 50 RABELSZ 19 (1986); Kirchner II, *supra* note 3; Kirchner III, *supra* note 3; Hein Kotz, *Rechtsvereinheitlichung—Nutzen, Kosten, Methoden, Ziele*, 50 RABELSZ 1 (1986); Karl M. Meessen, *Competition of Competition Laws*, 10 Nw. J. INT'L L. & BUS. 17 (1989); F. Parisi & L.E. Ribstein, *Choice of Law*, in 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 236 (P. Newman ed., 1998). For an analysis of potential advantages of varieties of law from an economic perspective, see Wolfgang Kerber, *Rechtseinheitlichkeit und Rechtsvielfalt aus ökonomischer Sicht*, in SYSTEMBILDUNG UND SYSTEMLÜCKEN IN KERNGEBIETEN DER HARMONISIERUNG. EUROPÄISCHES SCHULVERTRAGS UND GESELLSCHAFTSRECHT (S. Grundmann ed., forthcoming 1999).

42. Hayek's argument that the dispersed local knowledge in society cannot be centralised in one agency, which has been his main argument against the possibility of a centrally planned economy, can be applied to this problem as well. See Friedrich A. Hayek, *The Use of Knowledge in Society*, 35 AMER. ECON. REV. 519 (1945); see also Breton II, *supra* note 8, 185.

43. See *Zum Problem*, *supra* note 9; Kirchner III, *supra* note 3, at 78.

ment of competences to the different levels of jurisdictions for a given moment. But in the long run both new problems will emerge, and new techniques of problem-solving by economic policies will also be created, implying changes in the optimal structure of jurisdictions, or at least the optimal assignment of competences to the various levels of jurisdictions. For example, technological innovations might reduce economies of scale in the provision of certain public goods, or the regional heterogeneity of preferences might change, both leading to recommendations of shifting tasks to lower or higher levels. The problem, therefore, must be solved as to how the structure of jurisdictions and its vertical assignment of competences are adapted to ever-changing circumstances and problems. Who has the competence to decide the assignment of competences in such a system of jurisdictions? Or stated otherwise, who has the competence-competence?

Two extreme cases can be differentiated. In the first case, the competence-competence lies on the central level. In this top-down approach, a centralized decision will be made about the assignment of competences to all other levels of jurisdictions. Hence, it would be decided centrally on the optimal degree of decentralization. In the second extreme case, the lowest jurisdictions, municipalities, have the competence-competence, and they decide whether they want to shift competences to the next higher level of jurisdictions. In this bottom-up approach, there are decentralized decisions on the optimal degree of centralization. The decisive point is that in the second case the constituents of the lower jurisdictions have the right to transfer competences back to the lower level if they think they are better able to fulfill the respective task.<sup>44</sup> Another important difference is that those decentralized decisions about shifting tasks to lower or higher levels will be controlled by the competition processes among jurisdictions. This situation is not the case for central-

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44. A very interesting example of a bottom-up approach is Frey and Eichenberger's FOCJ-concept. Bruno S. Frey & Reiner Eichenberger, *FOCJ: Competitive Governments for Europe*, 16 INT'L REV. L. & ECON. 315 (1996); Frey & Eichenberger, *supra* note 9; FREY, *supra* note 1. In this stimulating concept of "functional, overlapping, competing jurisdictions" ("FOCJ"), the lower-level jurisdictions have the right to secede from higher-level jurisdictions, thus leading to the possibility of a territorial restructuring of jurisdictions. Beyond that, Frey and Eichenberger introduce the possibility of functional federalism as an important additional way of decentralization.

ized decisions about competence assignments. The competence-competence assignment on lower levels might help to avoid tendencies toward over-centralization. In any case, it is not enough simply to establish an optimal system of jurisdictions with an optimal vertical assignment of competences. It is also necessary to have a system of procedural rules in order to adapt to changing circumstances.

#### F. *Conclusions*

These considerations imply that a highly decentralized competitive jurisdictional system might have a superior capability for innovative development of institutional arrangements and economic policies, and hence can adapt more flexibly to new emerging problems. This conclusion might be especially true if the competence-competence exists at lower jurisdictional levels. In a decentralized system, errors in the sense of wrong economic policies tend to be automatically eliminated by the competitive jurisdictional processes themselves. In a centralized system, however, institutional innovations and the elimination of errors tend to be much more difficult because the necessary collective decisions at the central political level are much slower and lead to inefficient results. If we are convinced that we really know which economic policies will best solve our problems, and that the recommended policies will also be implemented adequately by the politicians on the central level, then a more centralized system might be advisable. But if we are skeptical regarding both issues, and simultaneously think that we are living in a dynamic world with the constant emergence of new problems for which we still have to look for new solutions, then a more decentralized, competitive, and therefore innovative and flexible system of jurisdictions might be superior in the long run.

The basic preconditions for a functioning competitive jurisdiction, however, are decentralization of economic policies and mobility. But due to often considerable exit costs for many individuals, mobility seems to be limited, thus strengthening the jurisdictional monopolistic power over individuals. Political jurisdictional competition and constitutional constraints on governmental powers are therefore necessary, showing that jurisdictional competition can only be seen as a complement, and not as a substitute, to democratic political systems within competing ju-

risdictions. But it is important to see that the size of mobility costs is not given exogenously and, instead, depends on the institutional structure of the system itself. Removing obstacles to mobility, such as a mutual recognition of qualifications, reduces mobility costs. The mobility costs are also dependent upon the degree of decentralization. The more decentralized a system of competing jurisdictions is, the shorter the distance to other jurisdictions with different bundles of public goods, services, and taxes is, implying lower costs of mobility. In any case, rules that protect the right to exit and remove obstacles to mobility are necessary.

Jurisdictional competition may have similar positive effects in the form of new generations of innovations and control of monopolistic market power, as competition processes in ordinary markets. Multi-level systems of competing jurisdictions, therefore, may be especially innovative and highly adaptive to newly emerging problems. Many problems of potential market failures may arise on the other side, however, creating the necessity for a framework of rules for jurisdictional competition processes to ensure an appropriate working of these markets for public goods and services. Much research still must be concluded to find out which set of rules would be most appropriate.

### III. *INTERJURISDICTIONAL COMPETITION AS AN INTEGRAL PART OF THE CONSTITUTIONAL STRUCTURE OF THE EUROPEAN UNION*

#### A. *A Competitive System of Jurisdictions as an Internal Market for Public Goods*

The implications of the establishment of a competitive system of jurisdictions within the EC can be expressed thusly: if jurisdictions produce their public goods and services competitively within the EC, then an "internal market" also develops for public goods and services. The main difference between normal markets for private versus public goods and services is that it is the customers, not the goods and services, that are mobile. The establishment of interjurisdictional competition, with its provision of productive locations, therefore, can also be seen as an extension of the Internal Market Program and, hence, as an additional application of the principle of competition in the EC. Consequently, the opportunity arises for a large part of the pub-

lic goods and services that are being produced within the EC, including legal structures and regulations, to be provided less monopolistically and more competitively. The existence and working of such an internal market for public goods and services would depend on the degree of mobility of firms, individuals, and resources within the EC, the extent of decentralization of decisions on the supply of public goods and services, and the framework of EC rules for competition processes within the EC.

### B. *An Integrated System of Competition Rules for Firms and Jurisdictions*

The existing system of competition rules within the EC is based upon Article 3(g) of the Treaty establishing the European Community ("EC Treaty"),<sup>45</sup> which demands "a system ensuring that competition in the internal market is not distorted."<sup>46</sup> The European competition rules encompass mainly Articles 81 through 89 of the EC Treaty.<sup>47</sup> Whereas Articles 81, 82, and the Merger Regulation address restrictions of competition by private undertakings on normal markets, such as horizontal and vertical agreements, abuse of dominant positions, and mergers,<sup>48</sup> Articles 86 through 89 address policies of Member States.<sup>49</sup> Article 86 ensures that the rules of competition apply equally to public undertakings in the public sector of Member States and therefore has been used for deregulation to break up national monopolies.<sup>50</sup> Articles 87 through 89 of the EC Treaty should prevent Member States from distorting competition by granting state aid to domestic firms giving them a competitive advantage compared to their competitors from other Member States.<sup>51</sup> An important part of the system of competition rules are also the judgments of the European Court of Justice regarding Article 28

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45. Treaty establishing the European Community, Feb. 7, 1992, O.J. C 224/1 (1992), [1992] 1 C.M.L.R. 573 [hereinafter EC Treaty], *incorporating changes made by TEU*, *supra* note 2.

46. *Id.* art. 3(g), O.J. C 224/1, at 8 (1992), [1992] 1 C.M.L.R. at 589.

47. *Id.* arts. 85-94, O.J. C 224/1, at 28-31 (1992), [1992] 1 C.M.L.R. at 626-32.

48. *Id.* arts. 85-86, O.J. C 224/1, at 28-29 (1992), [1992] 1 C.M.L.R. at 626-28.

49. *Id.* arts. 90-94, O.J. C 224/1, at 29-31 (1992), [1992] 1 C.M.L.R. at 629-32; VAL-ENTINE KORAH, AN INTRODUCTORY GUIDE TO EEC COMPETITION LAW AND PRACTICE (5th ed. 1994).

50. EC Treaty, *supra* note 45, art. 90, O.J. C 224/1, at 29-30 (1992), [1992] 1 C.M.L.R. at 629.

51. *Id.* arts. 92-94, O.J. C 224/1, at 30-31 (1992), [1992] 1 C.M.L.R. at 630-32.

of the EC Treaty in the famous "Cassis de Dijon" decision,<sup>52</sup> and the Internal Market Program, which helped remove obstacles to the free movement of goods, persons, services, and capital.

An analysis of the types of competition processes that are protected by EC rules of competition shows that the rules refer to competition processes among firms in markets for private goods and services.<sup>53</sup> Although the rules also fight against certain kinds of economic policies of Member States, they do this only with regard to their distorting effect on competition between firms. But the EC rules of competition do not refer to interjurisdictional competition. They are not rules that determine which behavior of Member States is allowed or forbidden in competition among themselves. The objective of the rules is, rather, to ensure that Member States do not impede competition on the internal markets for private goods. Consequently, competition between Member States and other lower-level jurisdictions is not taken into account in the European system of competition rules.<sup>54</sup>

On the contrary, it can be argued that the omission of references to interjurisdictional competition tends to lead to an application of the existing rules on competition among firms, which threatens to impede the competitive processes among jurisdictions. An interesting example is the EC policy on state aids.<sup>55</sup>

52. *Rewe v. Bundesmonopolverwaltung für Branntwein*, Case 120/78, [1979] E.C.R. 649, [1979] 3 C.M.L.R. 494.

53. Beyond that, the basic freedoms of persons and capital are ensuring competition processes on factor markets such as labor and capital markets.

54. Some authors analyzing regional policy have seen the problem of ignoring locational competition. In this context, approaches of competition among regions as an alternative to traditional regional policy have been developed. See, e.g., J. Franke, *Die Regionalpolitik der Europäischen Gemeinschaft: Eine theoretische und empirische Analyse ihres Wirkungsgrades und der Entwurf eines Systems konkurrierender Regionen als Ergänzung zur Strategie der Marktintegration in der Gemeinschaft* (1989); K. Lammers, *Die europäische Beihilfenaufsicht im Spannungsfeld zwischen Wettbewerbsziel und Kohäsionsanliegen*, in *WIRTSCHAFTSDIENST* 509 (1996); U. van Suntum, *Regionalpolitik in der Marktwirtschaft. Fremdkörper oder notwendige Ergänzung?*, in *JAHRBUCH FÜR REGIONALWISSENSCHAFT* 110 (1984).

55. For a thorough analysis of the EC policy on state aids, see G. Färber, *BINNENMARKTGERECHTE SUBVENTIONSPOLITIK IN DER EUROPÄISCHEN UNION; STRUKTUREN, NORMEN UND DEFIZITE* (1995); M. Rosenstock, *DIE KONTROLLE UND HARMONISIERUNG NATIONALER BEIHILFEN DURCH DIE KOMMISSION DER EUROPÄISCHEN GEMEINSCHAFTEN* (1995). For a more detailed analysis of the following argument, see Wolfgang Kerber, *Die EU-Beihilfenkontrolle als Wettbewerbsordnung: Probleme aus der Perspektive des Wettbewerbs zwischen Jurisdiktionen*, in *EUROPÄISCHE INTEGRATION ALS ORDNUNGSPOLITISCHE GESTALTUNGSAUFGABE* 37 (D. Cassel ed., 1998).

From the economic perspective, the EC activities to reduce the subsidies of Member States are very important and desirable. But the problem is that there are many, and very tricky, methods to circumvent the EC control of state aids by granting specific advantages to firms through the manipulation of real estate prices, zoning regulations, special rebates from local utilities, etc. If the Commission wants to prevent these forms of advantages in the context of firm settlements, then it must control all kinds of jurisdictional policies, and must develop criteria explaining under what conditions specific municipal policies are compatible with the Common Market. The consequence would be that the rights of these jurisdictions to decide freely on their policies, including public goods and services, would be restricted considerably and their possibilities to experiment with new kinds of policies to improve the conditions of their location would be strongly reduced. Although the basic objective of the EC state aids policy might be desirable, a problem arises because the subsequent application of the rules might lead to an unintended centralization of policies of lower-level jurisdictions, and hence impede innovative competition processes among those jurisdictions.<sup>56</sup>

The problem can also be explained in a more general form.<sup>57</sup> If the elimination of competitive distortions means that competition between firms must proceed entirely uninfluenced by economic policies of jurisdictions within the EC, and different cost conditions between Member States are only allowed due to differences in "natural conditions," then the effects of policies of lower-level jurisdictions on the competition between firms must be neutralized through, for example, centralization or harmonization of those policies within the EC. This problem is not limited to state aids granting selective advantages to firms. Additionally, movements among the tax rate, educational level (resulting in a more productive workforce), or infrastructures and, therefore, each improvement of local jurisdictional conditions, leads to a competitive advantage for firms that are established in the jurisdiction, as compared to firms in other jurisdictions.<sup>58</sup> If

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56. Kerber, *supra* note 55, at 52.

57. *Id.* at 56.

58. The EC does not actually go that far in the interpretation of "distortion of competition," but it is not easy to argue what the difference is with regard to this type of "distortion" between a specific tax reduction for a domestic firm, which is a prohibited

an undistorted competition between firms implies the need for firms throughout the EC to face the same economic policies<sup>59</sup> to prevent competitive advantages over firms that have their cause in economic policies of certain jurisdictions, then ultimately there must be a "leveling of the playing field" in which the economic policies of all jurisdictions within the EC are standardized and, therefore, decentralization is abolished.

But this consequent interpretation of "undistorted competition" leads to the abolition of any meaningful form of decentralization, implying the complete elimination of any interjurisdictional competition by experimenting with different forms of bundles of public goods, institutions, and taxes for the improvement of locational conditions. The permission of heterogeneity concerning jurisdictional economic policies is a necessary requirement for the workability of interjurisdictional competition with the potential effect of innovations and the control of governmental power. If lower-level jurisdictions, however, still have competences on deciding freely on their economic policies, then interjurisdictional competition as a constant process of experimentation and, therefore, productive locational competition, would be possible. But then the firms would face different locational conditions that are not only caused by differences in "natural conditions," but also by different economic policies of lower-level jurisdictions. A tension, thus, appears to exist between undistorted competition among firms on the European markets for private goods and interjurisdictional competition on the European markets for public goods and services.

The problem, rather, lies in the narrow interpretation of "undistorted competition," which is not more appropriate within a competitive system of jurisdictions in which economic policies of jurisdictions are controlled by competition, and mobility between jurisdictions is ensured. First, different local jurisdictional conditions do not lead to competitive distortions between firms in the long run if firms can freely decide on the location of their investments in the EC. If all firms have the right to settle in each

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subsidy, EC Treaty, *supra* note 45, art. 87(1), O.J. C 224/1, at 29 (1992), [1992] 1 C.M.L.R. at 628, and a general reduction of taxes by a Member State, because the latter leads to the same competitive advantage of domestic firms in relation to competitors of other Member States that do not get the advantages of lower taxes.

59. Such economic policies, including laws, regulations, and taxes, consist of the same level of public goods and services.



jurisdiction within the EC and, therefore, to use locational advantages, then the decision to stay in jurisdictions with less attractive conditions, presumably leading to higher costs, or move to more attractive jurisdictions, freely belongs to the firm. Second, in a competitive system of jurisdictions, the economic policies of the jurisdictions are no longer the result of states that have access to nearly unlimited tax revenues because of their monopolistic state power. Rather, the jurisdictions and their policies, including taxes, are controlled by competition. It is possible that this result would considerably limit the scope of distorting subsidies and other favors to specific firms.

Interjurisdictional competition and competition between firms therefore do not contradict each other. But the criterion of "undistorted competition" must be applied in such a differentiated manner that interjurisdictional competition, which necessarily must lead to heterogeneity among economic policies in EC jurisdictions, can work in a sufficient way. This reasoning certainly does not imply that there should be no rules that constrain the economic policies of jurisdictions. On the contrary, Part II argued that rules for the avoidance of market failure in competition would be necessary. The problem, rather, is that an integrated set of rules for competition within the EC is needed to ensure both competition among firms in markets for private goods and competition among firms in markets for public goods.<sup>60</sup>

### C. *The Problem of Regulatory Competition*

National regulations, such as consumer protection regulations, have been interpreted as non-tariff barriers to trade and therefore have been attacked by the European Court of Justice as being prohibited by Article 28 of the EC Treaty.<sup>61</sup> The introduction of the "principle of origin," or "mutual recognition," has

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60. The search for such an integrated set of rules may lead to new and currently unknown problems. A deeper analysis, for example, might raise fundamental questions regarding the compatibility of decentralization and mobility. The possibility that meaningful decentralization might imply phenomena, which usually will be diagnosed as barriers to mobility, cannot be excluded. For a more thorough but still very preliminary analysis, see *Zum Problem*, *supra* note 9; John Kincaid, *Liberty, Competition, and the Rise of Coercion in American Federalism*, in *COMPETITION AMONG INSTITUTIONS* 259 (L. Gerken ed., 1995); Viktor Vanberg, *Subsidiarity, Responsive Government and Individual Liberty*, in *ÜBERLEGUNGEN ZUR SUBSIDIARITÄT* 255 (K. W. Nörr & T. Oppermann eds., 1996).

61. See EC Treaty, *supra* note 45, art. 30, O.J. C 224/1, at 15 (1992), [1992] 1

resulted in firms from various Member States, whose products conform with their country's regulations, having the right to sell their products in all other Member States as well, even if they do not conform with domestic regulations.<sup>62</sup> All Member States, therefore, offer products to the consumers with different national regulations, thus leading to competition among national regulation systems because consumers can choose between different products of firms with different national regulations. This situation has been interpreted as competition among regulations, or regulatory competition, and an intense discussion has emerged as to whether these competition processes lead to desirable or defective results, i.e., a "race to the bottom" problem.<sup>63</sup> "Regulatory competition" raises many difficult questions, which suggest that the consequences of introducing the "mutual recognition" principle might be misinterpreted if it is viewed as an example for decentralized decisions on regulations, and competition among decentralized regulations, and if the rule of origin is seen as an appropriate meta-rule for regulatory competition among jurisdictions.<sup>64</sup>

The objective of most of these regulations has been consumer protection. For example, information asymmetries between producers and consumers concerning the quality of consumer goods might lead to the problem of adverse selection. This problem can result in a market breakdown for high quality products because consumers might not be able to distinguish between products with high and low quality. Introducing mandatory rules that ensure minimum quality standards might

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C.M.L.R. at 602 ("Quantitative restrictions on imports and all measures having equivalent effect . . . shall be prohibited between Member States.").

62. For descriptions and analysis of the very different developments, see P. Bernhard, "Keck" und "Mars"—die neueste Rechtsprechung des EuGH zu Art.30 EGV, in *EUROPÄISCHE ZEITSCHRIFT FÜR WIRTSCHAFTS—UND STEUERRECHT* 404 (1995); DINNAGE & MURPHY, *supra* note 5; Mortelsman, *supra* note 5; P.-Ch. Müller-Graff, *Kommentierung von Art.30, in 1 KOMMENTAR ZUM EU/EG-VERTRAG* 631 (H. Groeben, J. Thiesing, & C.-D. Ehlermann eds., 5th ed. 1997); Rohe, *supra* note 3, at 12; Slot, *supra* note 5; Streit & Mussler, *supra* note 5; Manfred E. Streit & Werner Mussler, *Wettbewerb der Systeme und das Binnenmarktprogramm der Europäischen Union, in EUROPA ZWISCHEN ORDNUNG-SWETTBEWERB UND HARMONISIERUNG* 75 (L. Gerken ed., 1995); Sun & Pelkmans, *supra* note 24; Stephen Weatherill, *After Keck: Some Thoughts on How to Clarify the Clarification*, 33 *COMMON MKT. L. REV.* 885 (1996); Weatherill & Beaumont, *supra* note 5.

63. Gatsios & Holmes, *supra* note 9; Hauser & Hösli, *supra* note 9; Siebert, *supra* note 24; Siebert & Koop, *supra* note 9; Sun & Pelkmans, *supra* note 24; WOOLCOCK, *supra* note 24.

64. For greater detail regarding the following argument, see Kerber, *supra* note 41.

solve this problem.<sup>65</sup> Since the market failure has its cause in consumer information deficiencies, the rules about minimum standards must be mandatory so consumers are only offered products that conform to those regulations. The problem is that the national regulations that are competing with one another after introducing the principle of origin lose their character as mandatory regulations for consumer protection. If consumers can choose between different national regulations, then the regulations are not truly mandatory. The regulations therefore have changed their character and become mere standards for producing certain goods. Thus, from the consumer point of view, different national standards of production compete with one another. But this simultaneously presupposes that the consumers are able to assess and compare the quality of different national standards of production. If consumers do not have enough information for such decisions, then competition processes among different national standards might lead to market failure.<sup>66</sup>

An additional important consequence of the rule of origin is that it retains the mandatory character of national regulations for domestic producers while consumers are allowed to choose between different national standards. The principle of mutual recognition, therefore, transforms the national regulations for consumer protection into *national regulations for domestic producers*, an entirely different regulation. The Member States now determine, with their national regulations, which quality product specifications domestic producers can use to compete with European competitors. It is difficult to conceive how this type of production regulation can be defended economically. Additionally, this type of production regulation leads to the problem of "reverse discrimination," as domestic producers have to observe regulations that their competitors from other Member States do not have to obey, implying potential competitive distortions. The introduction of the principle of origin, therefore, has not led to competition among national regulations for the protection of consumers, but has led to *competition processes among na-*

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65. See generally JOSEPH E. STIGLITZ, *INFORMATION AND ECONOMIC ANALYSIS* (1993).

66. But note that the information problem, and therefore the probability of adverse selection, differs considerably if we consider information problems of consumers with regard to the quality of many particular products or information problems regarding the quality of the entire system of regulations.

*tional regulations for domestic producers*, for which hardly any economic reasons exist. For competition between domestic producers, it is important to note that the competitiveness of the domestic industries becomes the main objective for all endeavors to change the national regulations instead of the protection of consumers. The danger therefore emerges that these national regulations are used as instruments of Member State industrial policies to support the competitiveness of their domestic industries.

These consequences, as well as potential distortions of competition by reverse discrimination, can be avoided if not only the consumers, but also the producers can choose between different national regulations. An example is if German firms can also produce along French or Italian standards, including the labeling requirement, without having to relocate their production facilities to France or Italy. In this case, an *internal market for regulations emerges*, in which fifteen national quality standards with their respective labels would compete for the trust of European consumers and use by producers throughout the EC. A real market would develop, in which all "suppliers," i.e., the fifteen Member States, and all "customers," i.e., directly, the producers, and indirectly, the consumers, are free in their development of new quality standards and in their choice between them.<sup>67</sup> It is also possible that innovative competition processes might develop, but now regarding quality standards, and not regulations, as mandatory rules. From the economic point of view, this type of competition would have considerable similarities to brand competition in consumer goods markets. Consequently, this market solution must be interpreted as deregulatory, which also must be viewed as the appropriate solution from the economic perspective, if the consumers are able to assess and compare the different national standards. And insofar as consumers are deemed unable to deal adequately with certain information problems, mandatory regulation might be necessary. But such rules must be established as mandatory rules on the EC level as, for example, minimum harmonization.

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67. But free entry is still missing on these markets because only the fifteen Member States would be allowed to offer quality standards. From the economic perspective, it would be consequent that private firms can also supply such quality standards. See Kerber, *supra* note 41.

The result of this very brief reasoning is that the introduction of the rule of origin, or mutual recognition, does not really lead to regulatory competition for the goal of consumer protection. This situation is because the principle of mutual recognition implies that national regulations are not mandatory anymore for consumers in the respective Member States. Rather, there is either competition among mandatory quality regulations for domestic producers, which from the economic point of view does not make much sense and can lead to other undesirable consequences, or a market for quality standards develops if the producers can also choose among the national quality standards. But the latter case does not represent competition among regulations; rather it must be interpreted as a pure market for quality standards and stand for deregulation because no mandatory rules exist anymore. So regulations for consumer protection can only exist either as rules on the EC level that are mandatory throughout the Community, or as rules on the Member States level—but in the latter case, only the rule of home country control can ensure the necessary mandatory character of these regulations. Decentralized competences for regulation can only be viewed in combination with the rule of home country control because the rule of origin abolishes the right of Member States to decide decentrally on mandatory regulations for consumers.

From the interjurisdictional competition perspective, therefore, only three consistent alternatives regarding regulation within the EC seem possible, including deregulation (private market solution), national regulations with “home country control,” and EC regulations, i.e., centralization/harmonization.<sup>68</sup> The introduction of the mutual recognition principle does not seem to be a sustainable alternative but, rather, a very important principle that sets off a *dynamic process of change* to break up the strong tradition of rigid, and often inappropriate, national regulations, leading to either deregulation or harmonization. This dynamic process of reshuffling regulation problems between the three alternatives is still going on. The introduction of the rule of origin should therefore not be seen as a meta-rule for regula-

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68. Any form of minimum harmonization with the possibility of stricter national regulations, combined with the principle of mutual recognition, may be a viable political compromise. But such a form suffers from similar difficulties and contradictions because the stricter national regulations can also only have the character of regulations for domestic producers, as argued above.

tory competition, but as a cause that triggers off a process of reallocation of competences for regulation between the three poles of national regulation, EC regulation, and deregulation (market solution).

If centralization or harmonization of regulations is undesirable because of the lacking regional differentiation among EC regulations for fulfilling different constituent preferences, or because of the long-run advantages of experimentation with regulations, then decentralized forms of regulation and an appropriate form of regulatory competition might be recommended. This Essay does not provide an answer about the necessary framework of rules for such solutions, but the rule of origin does not seem to be the appropriate answer. Additionally, it is not possible in this Essay to elaborate on what regulatory competition might really mean in the concept of interjurisdictional competition. The intent of these considerations is to show that the problem of regulatory competition is much more complex than has been seen up until now.

#### D. *The Problem of the Vertical Allocation of Competences in the EC*

A competitive system of jurisdictions should be constituted as a multi-level system of jurisdictions in which jurisdictions compete with one another on all levels. Crucial to those competition processes is the vertical allocation of competences for the provision of public goods and services, regulations, taxation, and other forms of policies. The economic theory of federalism provides criteria for how competences should be assigned to the particular jurisdictional levels, such as spill-over effects, economies of scale, heterogeneity of preferences, transaction costs, and learning effects by experimentation. Since decentralization of competences is a precondition for interjurisdictional competition, each transfer of competences to higher levels, or especially to the top-level of such a multi-level system, eliminates competition processes. Decentralizing competences can therefore be interpreted as a process of competitor cartelization<sup>69</sup> that would require efficiency gains such as economies of scale, or a solution for market failures.<sup>70</sup>

The most apparent dangers for interjurisdictional competi-

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69. Stefan Sinn, *supra* note 9, at 188.

70. Certain similarities to the problem of exemptions from the prohibition of

tion within the EC, therefore, are all activities that transfer competences from Member States, or more generally, from lower-level jurisdictions, to the central level of the EC. In the last two decades, the purposes of the EC in Article 2 of the EC Treaty,<sup>71</sup> and the instruments in the form of new EC policies, have both been widely extended, as exemplified by the long list of "activities" of the Community in Article 3 of the Treaty.<sup>72</sup> Many new competences have therefore been transferred to the EC.<sup>73</sup> But the principle of subsidiarity in Article 5 of the EC Treaty has also been introduced.<sup>74</sup> From an economic point of view, the above criteria for the economic theory of federalism can be used to operationalize the principle of subsidiarity. But the problem is that Article 5 of the EC Treaty is not a legal norm for the general allocation of competences in the EC but, rather, "its function is limited to the application in mixed fields of competences."<sup>75</sup> Legal scholars, therefore, are very skeptical about the impact of the principle of subsidiarity in Article 3(b) with regard to the impediment of over-centralization in the EC.<sup>76</sup>

To what extent the above criteria for the vertical allocation of competences in the concept of interjurisdictional competition would lead to a different assignment of competences as they exist today in the EC cannot be discussed here. An analysis along these criteria, however, leads to the conclusion that the current allocation does not correspond to these criteria, presumably suggesting that some competences should be transferred to higher levels and others to lower levels of jurisdictions.<sup>77</sup> But another

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agreements restricting competition in Article 85 of the EC Treaty therefore emerge. See KORAH, *supra* note 49, at 63.

71. EC Treaty, *supra* note 45, art. 2, O.J. C 224/1, at 8 (1992), [1992] 1 C.M.L.R. at 588.

72. *Id.* art. 3, O.J. C 224/1, at 8 (1992), [1992] 1 C.M.L.R. at 588-89.

73. For a critical analysis of this development, see Manfred E. Streit & Werner Mussler, *Evolution of the Economic Constitution of the European Union*, in 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 98 (P. Newman ed., 1998); Streit & Mussler, *supra* note 5.

74. EC Treaty, *supra* note 45, art. 3(b), O.J. C 224/1, at 8 (1992), [1992] 1 C.M.L.R. at 588.

75. Kirchner III, *supra* note 3, at 75.

76. See Bernard, *supra* note 3; Emiliou, *supra* note 3; Homann & Kirchner, *supra* note 3; Kirchner I, *supra* note 3; Kirchner II, *supra* note 3; Kirchner III, *supra* note 3; Koenig & Haratsch, *supra* note 3; Möschel, *supra* note 3; Rohe, *supra* note 3; Sinn, *supra* note 3; Steiner, *supra* note 3; Toth, *supra* note 3; Van den Bergh, *supra* note 3.

77. For a more concrete explanation to the questions that should be asked in such an analysis, see Kirchner I, *supra* note 3; Kirchner II, *supra* note 3; Kirchner III, *supra*

aspect should also be emphasized from the interjurisdictional competition perspective. A central task for the EC would be the provision of the institutional framework that ensures the working of the multi-level system of jurisdictions and therefore the necessary rules for competition among lower-level jurisdictions. Consequently, the extension of purposes and policies on the EC level does not need to be an impediment to interjurisdictional competition if the competences for certain economic policies on the EC level are not used to replace or harmonize lower-level policies. Rather, it would be understood as the competence to establish appropriate rules for the respective competition processes of lower-level jurisdictions. European social policy, for example, does not need to imply European social security systems or social standard harmonization, but can also consist of a framework of rules that focus upon the parallel existence of decentralized social security systems. An example of this problem is the issue caused by migration between Member States.

#### *E. Interjurisdictional Competition as a Concept for European Integration*

The dangers of general harmonization and centralization, and therefore the transition to a central state, does not seem to be realistic in the near future, although the tendencies to centralize still exist and will be fueled by the European Monetary Union. But the still existing EC decentralization might be strengthened by the introduction of the subsidiarity principle and, thus, does not stand on a very strong theoretical basis. In discussions concerning European integration, decentralization is not often seen as a constituent part of the integration process itself, but rather appears as the remainder of national egoisms, i.e., as the anti-pole of integration. Integration often is associated with the notion of uniformity, and ultimate integration with

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note 3. Also see the proposal of the European Constitutional Group as established additionally to the Union Court of Justice, a subsidiarity court whose members would be empanelled from the highest courts of the Member States. The subsidiarity court would decide exclusively on the division of powers between the Union and the Member States. Roland Vaubel, *The Constitutional Reform of the European Union*, 41 *EUROPEAN ECON. REV.* 443, 448 (1997). See also Thomas Apolte, *Secession Clauses: A Tool for the Taming of an Arising Leviathan in Brussels?*, 8 *CONST. POL. ECON.* 57 (1997) (discussing problems of secession clauses); Daniela Obradovic, *Repatriation of Powers in the European Community*, 34 *COMMON MKT. L. REV.* 59 (1997) (discussing possibilities of repatriation of powers in EC).



the achievement of the traditional unitary state, only now on the EC level instead of the national level.

Interjurisdictional competition is different. Decentralization is not opposed to integration, but should be understood as a constituent part of European integration itself. Therefore, *the suggested competitive system of jurisdictions should be viewed as a concept for European integration*. It is thus necessary to show which functions economic decentralization has for the Community. The contention is that European integration can be much more successful at fulfilling the preferences of the European constituents if the strategy to establish a competitive system of jurisdictions is chosen instead of being guided by traditional concepts of unitary national states.<sup>78</sup> This statement does not imply that the EC would not have many tasks and competences. The EC has had the huge task of establishing an appropriate framework of rules to ensure basic freedoms and an internal market for private goods and services. The same task would also be necessary to ensure the proper working of a decentralized system of competing jurisdictions. The basic idea behind this model of integration is to establish a framework of rules that through competitive experimentation processes allows a high flexibility and adaptability of both jurisdictional structures and economic policies, and enables newly emerging problems to be solved more rapidly and thoroughly. Innovative learning processes, therefore, would be institutionalized.

The current hierarchical structure of jurisdictions, consisting of the EC, Member States, and lower-level jurisdictions, can be viewed as the starting-point for the development of a multi-level competitive system of jurisdictions in which the provision of public goods and services should be assigned as low as possible. The EC rules for the Common Market would necessarily be an integrated system of competition rules that would protect both competition among firms for private goods and interjurisdictional competition for public goods. As a consequence, jurisdictions would compete for most economic policies.<sup>79</sup> Only those economic policies carried out on the EC level would be supplied

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78. For a presentation of the idea that institutional competition should be seen as a concept of European integration, see especially Kirchner III, *supra* note 3; Streit & Mussler, *supra* note 5; Streit & Mussler, *supra* note 73.

79. See FREY, *supra* note 1; Streit, *supra* note 20.

monopolistically.<sup>80</sup> The main problem is that the concept of interjurisdictional competition, both on theoretical and empirical grounds, is a rather new approach that still needs much research work. Especially important is the question of how the competitive system of jurisdictions, consisting of the rules on competition for both kinds of markets, the structure of the multi-level system of jurisdictions including the vertical allocation of competences, and meta-rules for changing these rules and the structure of jurisdictions including the problem of "competence-competence," should be conceived as an integrated and consistent framework of rules, and therefore as a central part of the European Constitution.

#### IV. *PERSPECTIVES*

In economics, states traditionally are viewed as monopolies that provide their public goods and services unilaterally because their individuals, firms, and factors of production are seen as immobile. For a long time this monopoly paradigm of economic policy dominated our thinking about economic state policies. In the past decade, the mobility of individuals, firms, and capital has increased considerably and is expected to increase in the future as well, and economic state policies have come under competitive pressure. Former monopolistic states seem to change into mere "locations" that must compete with other locations for public goods and services. The monopoly paradigm of economic policy, therefore, tends to be replaced by a competition paradigm of economic policy.<sup>81</sup> This development should be seen as an opportunity.

Decentralization of economic policies still exists within the EC to a considerable extent, and the obstacles to mobility have been reduced dramatically. But interjurisdictional competition is largely ignored as a logical consequence of the development of European integration and the concrete application of the EC Treaty. This occurrence is resulting in various tendencies to reduce decentralization, and hence to impede interjurisdictional

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80. Insofar as mobility exists across the EC borders, competition among jurisdictions may also take place on that level. All these considerations, therefore, can also be applied to the global level and to the question for the appropriate global framework of rules.

81. *Erfordern Globalisierung, supra* note 9.

competition. The basic problem is not whether we want interjurisdictional competition, but the conclusion is that if we want simultaneous mobility and decentralization, then we must accept interjurisdictional competition and we must think about ways to make competition processes workable. The concept of interjurisdictional competition suggests that, within an appropriate framework of rules, competition processes might not only be workable, but also might even lead to more desirable outcomes regarding the innovative improvement of the provision of public goods and services, and their efficient production, than traditional monopoly states. Through the establishment of appropriate rules for a competitive system of jurisdictions, therefore, an internal market for public goods and services can also develop.

Although competition and the completion of the internal market are viewed as basic principles of European integration, locational interjurisdictional competition, and hence markets for public goods and services, are not yet constituent parts of the EC. Consequently, the central task for the EC would be the establishment of a framework of rules that would ensure both competition between firms for the provision of private goods, and interjurisdictional competition for public goods. The alternative to this solution would be the simple transfer of the old traditional monopoly paradigm of economic policy to the EC level, implying the replacement of centralized nation states by a much larger centralized Community. If innovativeness, diversity, flexibility, and responsiveness to the preferences of the constituents within Europe should be maintained, then new concepts must be developed.