

Comment on Simon Deakin: Is regulatory competition the future for European integration?*

Rickard Eriksson**

I would like to thank professor Deakin for his very interesting speech on the pros and cons of the European and the American model of regulatory competition for corporate law. I agree that both models have their merits and that the European model, with more diverse practices, provides an opportunity for learning, which is lacking in the American model.

The policy issue at stake is whether Europe should go for a competitive federalism model of American style for corporate law. My main point is that although the American experience is an interesting benchmark, it would not be possible for Europe to mimic the American model, simply because the legal system of the EU is different from that of the US in many respects. Because of these differences, we cannot get the American outcome in Europe, even if we want to. If we introduce competitive federalism for corporate law in Europe, we will get something else instead.

One important difference between the legal systems of the EU and the US is that the lawmaking power of the federal level is much weaker in the EU. There are also other differences, but I will concentrate my comments to this one. So what I am going to do is the following: First, I will describe the role of the federal level in a competitive federalism model. Then, I compare the federal level in the US and the EU. And finally, I conclude that the much weaker federal level in Europe will lead to a more *laissez faire* outcome in Europe than in the US.

It is the member states which make corporate law in a competitive federalism system; nevertheless the federal level is very important. First, the federal level is necessary to uphold the principle of mutual recognition of corporations registered in different states of the federation. Second, the federal level has to define the boundaries of corpo-

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** Rickard Eriksson is a Researcher in Economics at the Swedish Institute for European Policy Studies, SIEPS.

rate law. What is corporate law and what is not? For example: Accounting rules are important for tax law and corporate law. The exact demarcation between corporate law and tax law will be very important if we have regulatory competition in corporate law but not in tax law. Third, regulatory competition may lead to extreme coordination failures of the prisoners' dilemma type, and then it is appropriate for the federal level to intervene.

So what does the federal level do in the US? As has been pointed out by e.g. Roe (2005), Washington plays an important role in making American corporate law. In cases where Washington has deemed the outcome of the competition between states as unsatisfactory it has made corporate law itself, such as for inside trading, takeovers and share voting rules. But maybe more important is the fact that the threat of federal legislation can affect state regulation. These threats are, at least sometimes, to be taken seriously. Even the possibility of moving all corporate law from the states to Washington has been mentioned in the debate.

Federal decision-making in the EU is more complicated than in the US. Some decisions require unanimity, others require a qualified majority. Each member state in the EU has a certain number of votes. The qualified majority must represent 72 percent of the votes and 62 percent of the population of the EU, as well as a majority of the member states. Examples of areas where unanimity is needed are tax policy and social policy and examples of areas where qualified majority voting is used are trade policy and common market issues.

Let us first consider what will happen if we introduce competitive federalism for corporate law in Europe and federal decisions on corporate law are decided with unanimity. We know that regulatory competition as in the American model leads to a concentration of companies to one Member State, as it has done in Delaware in the US. The winning Member State can always vote against federal legislation, and that is enough to block federal intervention. This is a problem if a severe coordination failure occurs, where all member states, other than the winning one, lose out on regulatory competition. Unlike in the US, the federal level in the EU will not be able to intervene, since the winning Member State will consistently vote against federal legislation. One could argue that a possible solution to this problem is to issue side payments to the winning Member State, but it is a slow and inefficient solution. This can be illustrated with an example from tax policy, where decisions must be taken unanimously.

When the free movement of capital was introduced in the EU in 1992, it led to a huge capital flight to Luxembourg. This substantial negative externality for the other Member States could, in principle, be solved by a side payment to Luxembourg. Nevertheless, it took the other Member States over ten years to convince Luxembourg that capital gains taxes should be paid on bank accounts, and the negotiated solution is still quite inefficient. All this because Luxembourg could use its veto on tax issues.

Qualified majority voting is another story. Most companies will be concentrated to one Member State. If there are large negative externalities for other Member States, it will be easy to reach a qualified majority for federal intervention. That a qualified instead of a simple majority is needed is of no great importance.

To sum up, it is very important whether corporate law falls under the unanimity or the qualified majority rules. In principle, the EU could decide to let corporate law fall under the qualified majority voting rules. In that case, the federal level in the EU will not differ so much in power from the federal level in the US. One complexity, however, is that some issues concern several policy areas. If such an issue is primarily deemed to be a tax or a social policy issue, for example, rather than a corporate law issue, it will be decided unanimously. Also, the *Centros* case opens up the possibility that regulatory competition in corporate law may result from judicial decisions. In that case, we may need unanimity or even treaty revisions to change the rules.

My conclusions are that the EU is a much weaker federal regulator of regulatory competition than the US, at least when unanimity is required. Regulatory competition would therefore be likely to be much cleaner in the EU than in the US. There are possible benefits from cleaner competition. Some authors argue that the federal level in the US intervenes too much in corporate law. But there would also be a risk that the EU would not be able to handle bad outcomes that result from extreme coordination failures, where all member states but one lose from regulatory competition.

My comments have only dealt with one aspect of this subject. Let me conclude by saying that there are many more issues that should be discussed if we are to seriously consider introducing a competitive federalism model for corporate law in Europe and I think that professor Deakin's speech today provides an excellent introduction to this complex subject.

References

- Roe, M. (2005), Regulatory competition in making corporate law in the United States—and its limits, *Oxford Review of Economic Policy* 21, 232-242.

