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Political Yardstick Competition and Corporate Governance in the European Union

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Abstract

The question whether regulatory competition in the area of company law could take place in the European Union (EU) in a way similar to the form it takes in the United States (the Delaware phenomenon) is topical because of some recent judgments of the European Court of Justice and various documents and projects produced by the European Commission. That question is typically discussed, however, as if voters did not count and as if competition among governments was exclusively based on the mobility of firms across jurisdictions. But intergovernmental competition can also take the form of yardstick, or relative performance, competition. Voters and democratic politics then become essential. Voters assess the performance of incumbents by comparing what obtains in their own and in other jurisdictions. The first part of the paper is devoted to spelling out some characteristics of the mechanism. It notes in particular that, depending on circumstances, yardstick competition may provide office-holders with the wrong incentives. This result is important in the EU context. The second part stresses some aspects of the path followed by European integration. One property is that Europe is under construction, entailing a tendency for integration to be monotonous. The process of integration can slow down or stall but seldom if ever regress. Another feature is the enduring reliance on the internal market commitments and their legal implications. Structural characteristics of the integration process such as these have consequences on yardstick competition as well as on the kind of policies to be expected from the EU. The third and fourth parts of the paper are devoted to corporate governance and law making in the EU context and in the light of the foregoing analysis of yardstick competition. Two points are stressed. The nature of yardstick competition among the governments of the member countries may explain that differences in company law and corporate governance can subsist without preventing a strong convergence of economic outcomes. Yardstick competition between the EU as a whole and other parts of the world, however, is likely to start a dynamic process that could lead to the centralization of a large part of company lawmaking at the EU level and the emergence of a distinctive legal environment for firms doing business in Europe.

Keywords: yardstick competition, european integration, regulatory competition, corporate governance

JEL Classifications: D72, F02, G38, H77, K22

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1. Introduction

Competition among governments is generally treated in a way that leaves no room for voters and democratic elections. This is as true of regulatory competition in the area of corporate law as it is of tax competition and, more generally, of all forms of competition among governments that aim at attracting or keeping households, firms or capital. If, instead of being elected and accountable to voters, governments were dictatorships or purely private institutions, this would entail very little change in the major strands of the literature on intergovernmental competition.

On the contrary, this paper is based on a perspective under which voters and elections are central. Competition is assumed to take place in different arena. Within each jurisdiction, candidates or political parties compete to win elections. Or, to put it in a more convenient way for our purpose: because of electoral competition, incumbents do their best to be reelected. The problem is that voters encounter serious information problems, especially in a world that changes rapidly and irregularly. Hence the utility for them of comparisons of what obtains in their own jurisdiction and what obtains in others. As we will see, this can stimulate a form of competition, currently called yardstick competition, in which the governments of the different jurisdictions vie for a good place in terms of relative performance - a purely informational and intangible good, but, because of competition in the first arena, a most valuable one. Then, of course, there is also intergovernmental competition of the more conventional type, in which agents (households, firms, capital) respond to differences in what the governments offer them by exit (and entry) rather then by voice (and support), to use Hirschman's well-known distinction (1970). This form of competition must also be taken into account in most concrete situations. In fact, by its strength, it often pre-empts yardstick competition.

Has this approach anything to contribute to the understanding of regulatory competition in the area of corporate law and governance? I will address the question not as such but in one of its specifications. Does yardstick competition play a role in the way regulatory competition and harmonization or centralization interact in the area of corporate law and governance and in the setting of the European Union (EU)? In a most exploratory and tentative way, I will try to show that this is the case - a positive answer that logically extends, with the same caveat, to the larger question. My tentative demonstration is based on an interpretation of the way policies are decided and implemented in the EU. One implication of that interpretation is that EU policy-making in one area - corporate law and governance being an instance - cannot be really understood or predicted independently of what the EU does in other areas. Issue linkages, especially over time, are a major feature of the way integration proceeds in Europe.

Sections 2 and 3 summarize important aspects of yardstick competition among governments and of decision-making in the EU, respectively. I turn then to corporate governance and law-making in the EU context. In Section 4, I try to demonstrate that yardstick competition among the governments of the member countries may explain that differences in corporate law and governance can subsist without preventing a strong convergence of economic outcomes. The point made in Section 5 is that yardstick

competition between the EU as a whole and other parts of the world may well start a dynamic process leading eventually to the centralization of a large part of corporate law-making (in a broad sense) at the EU level and the emergence of a distinctive legal environment for firms doing business in Europe. Section 6 is a brief conclusion.

2. Selected features of yardstick competition among governments

The basic mechanism can be summarized as follows (Salmon 1987).[1] The main problem encountered by voters, especially in a world in which there are many changes and much uncertainty, is information asymmetry. Given circumstances that they do not know, or whose impact they cannot assess, the voters of a jurisdiction J cannot say whether the performance of their government - or a set of its decisions and policies - is good or bad. If disturbances are not wholly idiosyncratic to J but, to a sufficient degree, correlated across different jurisdictions, the observation of what obtains in some other jurisdictions may help voters in J to form an opinion. Thus, if a voter of J, in domains of interest to her, considers that it makes sense to compare the services delivered or the decisions made by the government of J to those offered or decided in some other jurisdictions, and if the result of these comparisons is that the said voter considers the relative performance of the government of J on the said matters to be bad, this may decrease the probability that she will vote for the incumbents on the next occasion.

Incumbents do not know exactly the domains that count most for that voter or for others, nor with what other jurisdictions she or others will compare what obtains in J. They know that exerting themselves as much and in as many areas as possible enhances the chance that their performance will be judged comparatively good by the voters of their own jurisdiction, and thus increases the probability that they will win the next election. If this is their main concern, this may produce in incumbents an incentive toward good performance, and moreover performance of a kind that tends to be aligned with the way voters themselves perceive their interests. The mechanism, however, may either not work or have perverse effects.

To complete the summary, let me introduce here an important distinction. If the jurisdictions with which comparisons are made are on the same level as J (as was perhaps implied by the formulation used so far), yardstick competition is horizontal. It takes place among the governments of cities, or of regions, or of countries or, as we will see, at the level of the EU as a whole. If jurisdictions are not on the same level, yardstick competition is vertical (I simplify somewhat). If C is a country and J a region of that country, voters in J may compare the performance of J's government with that of C's. If, as a consequence, they are pleased with the performance of J's government more

[1] In microeconomics or organization theory, yardstick competition can be traced back at least to Baiman and Demski (1980) even though it is usually associated with Shleifer (1985). In Salmon (1987), whose topic was political decentralization in a governmental system, the analysis was inspired not by yardstick competition but by the then recent literature on tournaments, in particular Lazear and Rosen (1981). Differences between the two mechanisms can be disregarded for our purpose. The title of Besley and Case (1995), the most influential work in that area, refers to “yardstick competition” and, as everybody else now, I will use that expression.

than with the performance of C's government, this makes them on average more likely to vote for the incumbents in the next *regional* election and less likely to vote for the incumbents in the next *national* one. The incentives of elected office-holders generated or strengthened in this may are more or less the same as previously.

The following seven features of the mechanism are particularly relevant for our purpose in this paper.

(1) Even though voters have idiosyncratic interests, some variables are a concern common to many. Thus, rather than the very general formulation above, it is often both more convenient and productive for certain purposes to assume that yardstick competition takes place mainly over one or a few salient variables. The one I will stress in the remainder of this paper is simply economic performance as measured by GDP growth and/or GDP per capita.

(2) The strength of the mechanism, measured by the degree to which incumbents feel constrained by voters' interjurisdictional comparisons, is determined by two sets of factors. The first is related to the availability of the relevant information and the attention given to it by the population or subsets thereof. The second is the nature of the political, and at the limit electoral, system. In other words, the strength of the constraint introduced by comparisons will depend, first, on how much discontent a given performance gap generates in the population, and, second, to what degree that discontent translates into genuine pressure on incumbents.

One's view about the nature of electoral competition has a very important bearing on the way both sets of factors can be assessed. A probabilistic view of voting (see Hillman 2003, e.g.) makes the mechanism much more plausible than it will be under the median voter assumption. Under the probabilistic approach, individual candidates and political parties consider *all* voters, or categories of voters, as having a positive, even if often tiny, probability of voting for them, and this probability is endogenous in the sense that it depends in part on the policies candidates implement or promise to implement. Thus the opinion of even relatively small constituencies might count, and consequently deserves some attention. If electoral competition is sufficiently tight, politicians will be attentive to interjurisdictional comparisons even if they know that only a minority of voters makes them. Moreover, if some features of the situation cause the mechanism to be relatively weak, that only means, regarding a potentially widespread concern such as economic performance, that a larger gap along that dimension will be necessary for the political constraint to become significant. A quasi-philosophical problem is that the observation of zero performance gaps and no visible comparative activities on the part of voters may be the result of office-holders having made sure, because of their awareness of the potential effect of yardstick competition, that no gap develops.

(3) As stressed by Breton (1996), voting is only one of the ways for the population or subsets thereof to award or withdraw support. Even in democratic settings, incumbents may be attentive to public opinion independently of elections, or, in specialized domains, to the judgment and support of groups that have no or little electoral power. This possibility gives these specialized domains a second chance - the

first resulting, albeit weakly by definition, from the probabilistic view just mentioned - to be host directly to yardstick competition.

(4) In any case, many areas that are not concerned directly by yardstick competition may be involved indirectly as a consequence of governments being engaged in yardstick competition along other dimensions. To illustrate, environmental concerns may be sacrificed as a result of a concentration on economic growth imposed by yardstick competition. Combinations of direct and indirect involvement may emerge as yardstick competition over a salient variable disturbs a second variable in a way that makes the latter also a salient issue in the public debate. As a consequence, that second variable may become also a politically significant object of voters' comparisons across jurisdictions and thus of yardstick competition. Not only may the actual working of this mechanism but also the awareness by office-holders that it could become active affect their current decisions.

(5) The relationship between yardstick competition and the better known form of competition based on the mobility of individuals, firms and capital is, in general, very complex. I will make only two remarks. Mobility-based competition often pre-empts yardstick competition. This seems to be clearly the case of the Delaware-type of interstate competition for incorporation in the United States. Yardstick competition plays little or no role in that competition as far as I know. One reason is that the mobility costs incurred by firms are particularly small. Another is that, except in Delaware, the consequences for constituencies other than managers and shareholders of the choice made by firms are also small (or perceived as such). Mobility-based regulatory competition in the European context is or would be a completely different matter.

The second remark, related to the first, is that the agents most likely to respond by mobility to differences in policies across jurisdictions may not belong to the same categories as the agents most likely to respond to these differences by their votes. To illustrate, if it is the case, as often claimed in the European context, that the mobility of labour across member countries is much smaller than that of capital, mobility-based competition may be above all something for the latter whereas yardstick competition may be the only possibility available to the former. Voters should of course take mobility-based competition, actual or potential, into account but this does not mean that, influenced by interjurisdictional comparisons, they will never decide collectively in a way that runs against what is induced by mobility-based competition. A policy more in favour of labour in country A than in country B may elicit a movement of capital from A to B but give the edge to A in terms of relative performance as gauged by labour-oriented voters in A and B - possibly inducing the government of B to emulate the government of A and adopt the same labour policy.[2]

(6) I indicated at the outset that yardstick competition may provide office-holders with wrong incentives. This may happen in various ways (Bordignon, Cerniglia and Revelli 2004). One important case for our purpose is when yardstick competition causes a convergence of policies and policy-outcomes toward a low-effort and low-

[2] Of course, assessments are likely to be biased according to party lines or in relation with internal debates - which raises a number of problems. See Heyndels and Ashworth (2003).

performance equilibrium. This phenomenon is more likely to arise when the number of compared jurisdictions is small or when comparisons are asymmetric, one jurisdiction serving as a benchmark for the performance of all others. If, in absolute terms, for some reason, that benchmark jurisdiction performs badly, this may induce the governments of the others to reduce the intensity of their efforts.

(7) Vertical yardstick competition can also be important (Breton 1996). In particular, it is in the essence of federalism, as conceived by its American inventors, that governments situated on two different levels "compete for the people's affection" (Pettys 2003). That type of competition is possible inasmuch as the governments operate to some degree in the same policy areas. In turn, this may result from the two levels officially sharing some powers or responsibilities, from the assignment of powers being ambiguous or flexible, or, most importantly, from the governments using different powers to intervene in the same policy area.[3]

Merely potential entry in a policy area may be enough to generate incentives. Suppose that only regional governments deal with some important issues in a given policy area and that the office-holders at the central level of government decide that they could do better than the regional governments to deal with the said issues. If the office-holders on the regional level think that the danger of invasion is serious, that the invader would be efficient, and that enough voters would notice the difference in performance, their concern with the probability to win the next election will generate among them an incentive to improve their own performance, and this even if, in fact, the invasion does not take place (Breton and Salmon 2001). The same mechanism of invasion can work in the other direction. Policies by subcentral governments may crowd out, or threaten to crowd out, inefficient policies by the central government in a domain that seemed to be its exclusive responsibility.

An important matter in this context is whether the rights of the different governments are entrenched. In federal systems, "regional" governments enjoy, almost by definition, some constitutional protection against the deeds of the central government. Otherwise - in unitary states - the competitive character of the vertical relation may be more fragile, the central government being tempted to change the rules (even if only about funding) when in danger of losing the race. I will return to the case of vertical competition in the EU.

3. The peculiar path borrowed by European integration

Sticking to a strategy devised by the founders, European integration is a roundabout and somewhat conspiratorial process.[4] Its raison d'être is mainly political – such as forging ties and constructing a political unit - but the concerns driving it at any point in time are largely economic – or, when not, of a practical and utilitarian character that makes them similar to economic concerns. The strategy has allowed integration to proceed without being burdened by the need to agree on its final destination. It has worked well so far in particular because new member countries have been socialized

[3] For another, more general, possibility, see Breton and Fraschini (2003).
[4] It is argued in Salmon (1995) that no conspiracy by elites need be assumed to account for these features.

over time into an understanding and acceptance of its nature. There is no reason to think that, eventually, that socialization will not operate also with regard to the ten countries entered in 2004. A number of features of integration follow. After listing them, I will consider the sequence associated with the Single European Act. As discussed later (in Section 5), it suggests one way corporate governance could evolve in the EU context.

3.1 Features of European integration related to the underlying strategy.

(1) The EU set-up is designed or contrived to be biased toward integration (Salmon 2003). One factor is the presence of expansionary incentives in institutions such as the Commission, the European Parliament and the European Court of Justice (ECJ). These incentives, natural in themselves, are strengthened by the duties assigned to the institutions. The Commission and the ECJ are "guardians of the treaties", and thus of the *acquis communautair*e entrenched in the accession treaties.

(2) In spite of the diversification of EU competences, the main legal basis used by EU institutions (the Commission and the ECJ in particular) to foster integration remains the same as in the 1950s and the 1960s: establishing a competitive and integrated internal market. Drawing all the implications of this goal has been and still is the main engine of integration and centralization in the EU (Salmon 2003).

(3) Unanimity is still required for many decisions (despite several rounds of extension of qualified majority-voting). The consequences of the unanimity rule, however, should not be misunderstood. It does not systematically reduce decisions, as often claimed, to a "lowest common denominator". Many arrangements are adopted unanimously in spite of a majority being hostile to them. What makes this possible is that issues are linked and positions over them are exchanged. Especially under a perspective of repeated interaction, this allows many policies favoured by only a majority, or even a minority, to be adopted unanimously. Thus the difference between (qualified) majority-voting and unanimous decision-making is more one of degree than of nature.

(4) Thus, whether or not the rule is unanimity or majority-voting, what will count is the intensity of preferences of all the members on all the issues over which linkages have been established. To make things even more complex, preferences include, or are biased by, a preference for (*europhily*) or against (*euroscepticism*) integration in general. An example is the agreement that yielded in 1986 the Single European Act. How could the British and the French governments, under Margaret Thatcher and François Mitterrand respectively, both acquiesce to the Single European Act? The Act was a major step in the sense of more integration. This was valued negatively by eurosceptic Thatcher and positively by europhile Mitterrand. But these negative and positive values were integrated in calculations that included also the British rebate, enlargement, and subjective expectations of increased competition, deregulation, and centralization.

(5) Integration has often slowed down or even stalled but seldom if ever significantly turned backwards, regressed. Reversals are not precluded but, in fact, their

occurrence is rarely plausible (Salmon 2004). The most important effect of this "monotonocity" is policy spillover or "*engrenage*". This mechanism, stressed and discussed a lot in the earlier literature on integration and a bit forgotten today, should be analysed now under the perspective of what the recent literature on the economics of transition calls "strong aggregate uncertainty" (Roland 2000). In a complicated aggregate process such as integration, decisions can have completely unforeseen consequences, escaping any probability calculus. However, contrary to the prescriptions of the said literature, in the EU context reversals are rarely an option. This affects the way the problem raised by aggregate uncertainty may be coped with. Suppose that it turns out that an integrative step decided or carried out earlier creates serious, unforeseen, problems and suppose that the solution consisting in reversing the integrative step is unavailable. The choice then is either to do nothing or to embark on a second integrative step in the hope that it will solve or mitigate the problems caused by the first. In turn, this second step may have unforeseen consequences, whose mitigation will be sought in further integration, and so on. Of course, the knowledge that an integrative step might start dynamics of that kind, even if it might make the first step attractive to some governments, justifies in most an attitude of extreme caution. That caution manifests itself in the form of both a reluctance to decide integrative steps and in a propensity to limit the size of the steps undertaken.

The overall bias toward integration finds its best and most important illustration in the vast, macroscopic, process of *engrenage* entailed by the commitment to implement a common market, as was agreed in 1957, or to "complete the single market", as was repeated in different words thirty years later. I turn to that dynamic now. It is highly relevant for our purpose in two ways. First, it is closely related to yardstick competition. Second, something akin to it may be emerging again from the current EU situation, this time involving corporate law-making more directly than it did in the 1980s. I will discuss these two points not now but in Section 5.

3.2 The dynamic generated by the Single Market commitment

Let me start the story with the famous *Cassis de Dijon* ruling of 1979, by which the ECJ interpreted the Treaty of Rome of 1957 as obliging, with exceptions, each member country to accept on its own market the products imported from any other member country provided these products satisfied the domestic regulations of that "home" country. This principle of mutual recognition, confirmed by other judgments, was a powerful way to fight impediments to the internal trade of products. It inspired the "new approach" to the harmonization of standards adopted by the Commission, and, as a consequence, together with an increased role for qualified majority voting (instead of unanimity) in the Council of Ministers, it became a major piece of the mechanism set by the Single European Act of 1987 and its "1992 programme" to "complete the single market". One remark at this stage: without the ECJ jurisprudence imposing mutual recognition, it is not all certain that governments would have agreed to it as they did in the Single Act.

With the Single Act, the member states undertook the elimination of all remaining barriers and impediments to trade within the Union and of the establishment of a "level-playing field" so as to eliminate all distortions to competition among firms.

This has had consequences whose significance was probably not foreseen by many of those who acquiesced to the undertaking (Salmon 2003). Some politicians and commentators apparently thought at the time that the result would be a decentralized market-oriented system of governance - something like the transposition to the EU setting of the system that Weingast (1993) defends under the name of "market-preserving federalism". Its characteristics, according to that author, are "first, that the authority to regulate markets is not vested with the highest political government in the hierarchy; and, second, that the lower governments are prevented from using their regulatory authority to erect trade barriers against the goods and services from other political units".

The Single Act did not produce this kind of system. Three facts explain why the outcome was different. First, in the Single European Act itself, as noted, the principle of mutual recognition was accompanied by a change in decision rules that allowed increased recourse to qualified majority voting for measures concerning the single market. The two ways in which the programme could be realized were deregulation and/or regulation centralization. The extension of qualified majority voting increased the feasibility of the second.

The second reason is related to the nature of the impediments to trade and distortions of competition that the Single Act purported to eliminate. Most manifestations of overt protectionism between member countries, such as tariffs and quotas, had been eliminated for some time. Thus the objectives of the single market programme implied contesting aspects of domestic policies that were possibly motivated by protectionism but could as well be claimed to pursue non-protectionist objectives. One aim of the programme was to bring to an end the fragmentation or segmentation of the market. Most if not all regulations by member states, however, do fragment or segment the market in some regard. A second aim, labelled "fair competition" or the establishment of a "level-playing field", consisted of preventing or eliminating distortions of competition. Many regulations again, but also subsidies (and other forms of aid) to firms, as well as privileges granted to the public sector, distort competition. To a large extent, however, all three categories are also unavoidable side-effects of policies that pursue "domestic", not *a priori* illegitimate, objectives (Breton and Salmon 2001).

Thus a purely negative process of elimination of all sources of fragmentation of the market and distortions of competition meant doing away with the domestic policies themselves, by ruling them out and/or by letting regulatory competition and mutual recognition do the job. This brings us to our third reason why the single market programme did not have the consequence that some expected. Doing away with the said policies was incompatible with the entrenchment of many of them in a social fabric common to all contemporary Western societies.[5] Getting rid of them would have involved drastically down-sized government. On the contrary, a positive process of centralization of policies at the Brussels level was compatible both with the aims of the single market programme and with the preservation of the main responsibilities of government in general.

[5] Including the United States under Reagan; see Rodden and Rose-Ackerman (1997).

In the domains in which the programme has been implemented, EU directives, typically on the basis of a claimed need to deal with a source of fragmentation of the market or a distortion of competition, have often intruded into matters that are left to junior governments in most existing federations - the examples of Canada and Switzerland being particularly telling in that respect. In the current EU set-up, reversing the process where it is clearly excessive, however, might seem to signal a renunciation to, or a dilution of, the single market commitment and would encounter the obstacles to reversals in general mentioned earlier. In a sense, unfounded centralization is the price to pay for constructing Europe in the way chosen.

4. Corporate law and yardstick competition among EU member countries

The influence of yardstick competition among governments on corporate law-making may be direct or indirect. A government may be directly influenced in its decisions regarding corporate law by the thought that some of its voters will compare what it does, or what the situation is in that policy area, to what is done or is the case elsewhere. The influence of yardstick competition is indirect when it has to do with variables unrelated to corporate law but having nonetheless an effect on the policies directly concerned with it. To complicate matters, policy sequences may increase the salience of some aspects of the social system in such a way that they become possible objects of yardstick competition. I will also return in this section to the possibility that yardstick competition leads to an unsatisfactory equilibrium and argue that, indeed, this has been the case in Europe for more than a decade.

4.1 Direct influence

A direct influence is less implausible in the EU than in the American context. The reason, as noted earlier, is that, in the United States, the costs of mobility from one jurisdiction to another are very low when that mobility concerns only incorporation. And there is not much harm in assuming that it concerns only incorporation because the characteristics of the legal environment of firms that are outside corporate law are more or less uniform across states. Two features of the European situation make the matter quite different. One is the “real seat” doctrine. Where that doctrine is enforced, mobility is more costly, imposing a displacement of substantial real activities. The other feature is that the part of the legal environments of firms which is not governed by corporate law but by various other legal and regulatory blocks is more diverse across EU countries than it is across states in America. Inasmuch as a part of these other regulatory blocks is related to the country of incorporation and/or of real seat, changing that country is a more consequential decision than if only corporate law proper was concerned. Thus it is less the case in Europe than it is in the United States that mobility-based competition over features of corporate law pre-empts yardstick competition over the same variables.

For direct yardstick competition over characteristics of corporate law to be significant, however, a precondition is that their salience is sufficient for politicians to

think that the way they deal with them might have an electoral impact. Admittedly, if we accept the probabilistic insights, it is not necessary that a concern be shared by a majority of voters for it to become relevant in electoral terms and generate incentives among incumbents. Corporate law affects large numbers of wage-earners and shareholders. It must be enough that only a subset of these large categories pays attention to it and makes use of comparisons with what obtains abroad for that to have a policy impact which we can consider a manifestation of direct yardstick competition. Yet casual observation does not suggest that this is very much the case, except with regard to some hot issues such as executive officers' and directors' pay or, in the wake of scandals, the need for more reliable accounts. Regarding wage-earners, one could argue that, in continental Europe, corporate law and other parts of the legal environment of firms protect them sufficiently and perhaps even a bit too much. This may explain that they are not strongly dissatisfied with the status quo.

What about small shareholders, a category which the literature generally considers as insufficiently protected by corporate law in continental Europe? It is true that gauging corporate law by the way of comparisons is a particularly complex exercise, notably because differences across countries often compensate each other, and different provisions or practices may be functionally equivalent (Kraakman *et al.* 2004). Thus it may be difficult for small shareholders to engage in comparisons across countries. But this informational obstacle could be overcome by the agency of intermediaries such as specialized media, associations, and politicians. In reality, the reason why shareholder's electoral pressure remains inexistent or modest should perhaps be sought not mainly in the obvious informational problems just mentioned but in the fact that current shareholders, after all, are not badly treated given the price they paid for their shares. The return expected by the marginal shareholder is comparable to what its brethren expect on the other side of the Ocean or the Channel. Otherwise, why for instance would American pension and mutual funds hold such a large proportion of the shares of the main European firms (30 per cent on average in France)? Inasmuch as there is some difference between the United States and the United Kingdom, on the one hand, and continental Europe, on the other, with regard to the protection of minority shareholders, this is reflected in the size of the stock-markets or the extension of shareholding (100 and 150 per cent of GDP in France and in the United States, respectively; a larger difference with the United States in the case of Germany and Italy).[6] Improvements in small shareholders' protection would constitute for them a sort of windfall. It is understandable that they are less likely to respond to the uncertain prospect of a windfall, their present position being fair, than they would if they had grounds to perceive themselves as victims of mismanagement or exploitation.

The fact that direct effects in this area will as a rule tend to be weak does not mean, however, that they cannot acquire some significance when, for example, scandals, or the remuneration of top managers, make it to the front pages of the press, as has happened recently. In addition, as noted, incumbents may seek support, independently of elections, from various constituencies (academics, lawyers, accountants, bankers, etc.) and these constituencies, even tough they do not face the information asymmetry obstacles encountered by voters, may nonetheless seek in

[6] The difference may also be reflected in the cost of capital.

international comparisons a way to evaluate the laws and regulations in force in their own country, stimulate the public debate about them, and, possibly, induce some change. The incentives provided in this manner to office-holders may not be very different from those provided to them by the main form of yardstick competition, that which involves voters.

4.2 Indirect influence

Yardstick competition among European countries over macroeconomic performance may account for some of the findings about corporate governance associated with the recent "Law and Finance" literature.[7] That literature uses a typology of four "legal families" or "origins" - English, French, Germanic and Scandinavian - to explain differences observable across countries in several sets of variables. Two variables are of interest to us here. One is the average performance of business firms or, related to that, the degree to which corporate law protects investors. The other is macroeconomic performance, as measured in particular by income per head or economic growth.

[Table 1 about here]

In Table 1, I have extracted some figures pertaining to European countries from Table 3 of Gugler, Mueller and Yurtoglu (2004) and recalculated the averages for the four legal families.[8] A look at Table 1 will confirm that there is something in the relationship between legal families and an indicator of the financial performance of firms, marginal *q* (defined as return on investment over cost of capital, and supposedly required to be at least equal to 1 if the interests of shareholders are to be maximized). By contrast (a formal procedure to establish that is not really needed), GDP long-run growth (32 years) shows little variation among the core European countries (the founding EU members in particular) - and even within the whole group once two outliers, Ireland and Switzerland, are (for reasons easy to provide) excluded.[9]

I will discuss differences over shorter periods, but, for the moment, I take as fact the existence, within the EU, of significant differences in the average financial performance of firms but not in (long-term) macroeconomic growth. The combination of these two observations is in need of some explanation. I suggest that yardstick competition over macroeconomic performance among the member countries of the European Union may contribute something to that explanation. To justify that proposition, I will argue, first, that yardstick competition precludes enduring differences in growth rates (never mind other possible sufficient causes for their absence), and then that the observed convergence of growth rates can be the outcome of very different arrangements regarding in particular corporate governance.

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[7] In this discussion, I will disregard the ten countries entered in 2004.

[8] Although all the countries selected, except Norway and Switzerland, are members of the EU now, only six were members over the whole period (1960-1992) to which the figures for GDP growth apply. Thus, including Norway and Switzerland raises no particular problem.

[9] In fact, it was conceded from the start by the promoters of the approach that came to be called the Law and Finance approach that the relationship between legal origins and economic growth could not plausibly concern developed countries (see La Porta *et al.* 1998).

As noted in Section 2, intergovernmental competition of the yardstick variety will be more effective when the political systems are themselves competitive, when information about what happens in other jurisdictions is readily available to the public at large, and when that public or a significant subset of it pays attention to that information. These conditions are fulfilled to a particularly large degree by yardstick competition among the governments of the member countries of the EU. In each of them, electoral competition is generally intense and incumbents are typically far from sure of being reelected. This makes them attentive to the state of all sectors of opinion. Moreover, information about what obtains in other member countries is abundant and widely commented. This can cover particular domains, of interest to single-issue categories of voters, but comparisons are more likely to constrain governments when they are focused on broad macroeconomic indicators such as unemployment and economic growth (or income per head).

Given this responsiveness of the political system and this high degree of information availability and awareness, an enduring or increasing negative performance gap in a country, as measured in particular by comparisons of economic growth with other countries, is likely to induce in that country a powerful reaction against the policies followed by the incumbents, and against the incumbents themselves if they prove unable to change policies in time. As far at least as the countries that have been members of the EU for a long time are concerned, a substantial and enduring divergence in income levels or rates of growth is thus unlikely.

The word "enduring" above is important, especially given the widespread perception that, in Europe, Britain is now doing better than the other countries in a kind of permanent or structural way. It must be recalled that Britain had a high level of income per head just after World War II, as compared to other European countries. Then, it had a negative performance gap in terms of economic growth but still not in terms of income per head over a relatively long period of time. This could be interpreted as reflecting a process of catching up by the other European countries. When income per head in the UK did fall below that of several other member countries of the EU (first Germany, then France, then, Italy), it needed some time for public opinion in Britain to react, but eventually, the reaction took place. The policy change was radical and, one may assume, it did cause the British economy to catch up. Currently, income per head in Britain is more or less equal to, when not slightly above, that of Germany, France, Italy and the Benelux countries (the differences are statistically insignificant). So far, thus, there is not much ground to assume an "enduring" difference in terms of macroeconomic performance between Britain and countries such as France, Germany and Italy. This does not imply however, that the recent success of the British economy does not inspire some interest among various constituencies and even among voters in these countries. Some pressure on politicians toward reforms ensues, but this phenomenon is embedded in a larger one, to which I will turn shortly.

Given the inferior record regarding financial performance of some of the countries included in Table 1, together with the absence of any ensuing gap in macroeconomic performance, either the first kind of performance has no impact on the second, or it is compensated somehow by the positive impact of other variables.

Because of the difference in financial performance, functional equivalence limited to corporate law, even understood liberally as in Kraakman *et al* (2004), will not yield the kind of equivalence required here. What we need is a functional equivalence between the policies and arrangements that allow different countries to achieve comparable levels of GDP per head or rates of GDP growth. Corporate law plays an important role, undoubtedly. But it is only one element of the legal environment of firms, other bodies of law - concerned with financial markets, labour, competition, bankruptcy, taxation, and the environment - being also important. And the legal environment of firms is itself only one the factors of macroeconomic performance over which governments may exert some influence. Other factors include transportation and communication, public services, aggregate levels of saving and investment, and education.

It is understandable and even unavoidable that the broader picture is often neglected in discussions focused on corporate law and governance. I will give a single example. Hertig and McCahery (2003) suggest a number of measures, to be taken at the EU level, that would facilitate litigation by minority shareholders - a mode of protection of their interests relatively underdeveloped in continental Europe as compared to the United States. One of these measures would be to allow, or to recognize, contingent fees. But do we really want to legitimise contingent fees in Europe? There are certainly advantages and drawbacks to such a decision, in both cases necessarily transcending the limits of corporate governance. Regarding the negative side, the main problem is not frivolous litigation, as discussed in their very interesting paper, but the aggregate level of litigation in general, and with it the number of people engaged in legal professions (lawyers, judges, law professors, etc). Several well-known economists - Gordon Tullock and Jack Hirshleifer in particular - have argued for a long time that the aggregate cost of litigation is increased in excess of any additional benefit by features typical of the American system - adversarial procedure, use of juries in civil matters, and practice of contingent fees, for example. I do not know whether they are right. The point is only that, both from a policy-oriented perspective and from a purely positive wish to understand economic growth differentials, the main issues of corporate governance should not be discussed in isolation.[10]

This brings me to the idea defended by Charreaux (2004): we should move from the idea of national systems of corporate governance to that of governance of national systems. An analysis that does concentrate on the characteristics of the national systems and treats differences in corporate law as relatively secondary is that of Roe (2003a, e.g.). In continental Europe, according to him, the agency problem central to corporate governance is not the risk of malfeasance, self-dealings, etc. on which most of the literature concentrates but the tendency among managers to follow policies that are not fully aligned on the interests of shareholders. The reason is the influence of the social

[10] A frequently met difficulty is that the incidence of a feature of the legal system cannot easily be restricted to a particular domain, such as corporate law. This is a general phenomenon. In early January 2005, on the occasion of one of the ceremonies in which French presidents speak at that time of the year, the incumbent president was understood to announce that something like class action would or should be introduced in France to improve the protection of consumers. This started a controversy in which it was clear that any reform was bound to involve domains other than that of consumers' protection. Along the same line, it must also be noted that different factors of macroeconomic performance may not be treated as independent explanatory variables in a separable function, as often assumed. More effect from one factor may entail getting less from another.

democratic tradition that is a characteristic of these countries. Given this nature of the agency problem, concentrated ownership of the firms is a way to monitor managers' decisions - block-holders having both the capacity and the incentives to ensure that managers follow policies that suit them or shareholders in general.

One can fully agree with the general approach adopted by Roe without subscribing, at least as far as France is concerned, to all his interpretations. The main traits of corporate governance in France are certainly in part related to social-democratic tendencies, as in the rest of continental Europe, and as Roe shows very well. This is particularly true and important with regard to lay-offs and to the downsizing of firms. However, perhaps as relevant, corporate governance is also related in France to the fact that nationalism or patriotism is a motivation shared, across the private-public divide, by CEOs, higher civil servants, and even private founders or owners of large industrial and financial firms (many members of the three groups being graduates of the same schools anyhow). This explains that the discretionary power of CEOs tends to be regarded in that country as something highly valuable, to be preserved at all costs, rather than the troublesome manifestation of an agency problem (which it is also, of course).

A concern with safeguarding this discretionary power, threatened potentially from three directions by shareholders, employees and some parts of the public administration or government, may explain much of the strategy the French managers have followed, with the acquiescence and help of the government, since the early 1980s (Hancké 2001). They have found in the international stock markets not only a source of finance and a convenient means to absorb other firms in France or abroad, but also an essential counterweight to pressures from employees or ministerial departments. Thanks to block- or cross-holdings and to government regulation (in particular with regard to lay-offs), they have protected themselves against pressure from shareholders and threats of takeovers from abroad. And CEOs have used this discretion to enhance the growth of the firms they managed - probably (going back to the values of q in Table 1) above the rate of growth that would have maximized the interest of shareholders. In a sense, the old managerial model of maximization of the size (or growth rate) of the firm under a minimal profit constraint (Baumol 1959, 1962) applies fairly well to contemporary French managers, albeit with the motivations underlying the growth objective partly different from that assumed in that model.

Interestingly, the large French firms that are family-held - Peugeot-Citroen, Michelin and many others - do not seem less growth-oriented than those which are not family-held and, in particular, those which have a diffused ownership. Is this surprising? In a recent issue of the *Financial Times*, the "willingness to take risk" observed on the part of Dassault Aviation was ascribed to "the company's lack of exposure to the stock market".[11] The views defended by Albert (1991), among others, in the late 1980s and early 1990s might be, after all, dormant rather than obsolete.

[11] Mark Odell, "Technology puts group in front", *The Financial Times*, 12 October 2004. The statement in the text is formulated by a consultant cited in the article. It is elaborated as follows: "Unlike their US competitors, Dassault does not have to worry about its stock price…Less than 5 per cent of Dassault shares are freely available to trade on stock markets with just over 50 per cent owned by Serge Dassault, the son of founder Marcel."

To sum up, for France at least, I think that it is not surprising that a system of corporate governance different from the one deemed optimal, and a low level of financial performance as measured by *q* in Table 1, prove compatible in the long run with a level of macroeconomic performance quite normal or average, as the same Table 1 indicates. This does not mean that characteristics of corporate governance that lead to some misallocation of capital (as measured here by *q* being less than 1) do not reflect *ceteris paribus* some kind of inefficiency. But the *ceteris paribus* clause here is dubious. The misallocation of capital may be compensated by many things - by more efforts or loyalty on the part of employees, for example. More importantly, let me recall that the whole normative discussion of the 1960s and 1970s about the merits of takeovers, the optimal level of investment, misallocation of capital, and so on, was concerned with efficiency and optimality, by no means with macroeconomic growth. It is the Law and Finance literature which has confused the two criteria.[12] From the standpoint of efficiency or optimality, growth can be excessive. Thus it is quite possible that the arrangements in place in a given country produce a high rate of growth and at the same time deserve to be deemed inefficient. For this to be the case, it is enough, for instance, that these arrangements cause capital to be misallocated and at the same time, through a higher level of aggregate saving, the total quantity of it to be larger.

4.3 Direct entailed by indirect

I have argued that, with some exceptions, yardstick competition has little direct effect on corporate law and works mainly at the level of macroeconomic performance. This is true in the absence of change, actual or potential. Competition to ensure a sufficient level of macroeconomic performance, however, may endow some issues, closer to corporate governance, with such a level of salience that they become objects of direct relationships.

The foregoing discussion on France suggests that, sometimes at least, what counts most for corporate governance may be the relative weight the government of a country and, in a sense, the country itself give to various concerns and issues. These may be the interest of shareholders as weighted against that of other categories, the degree of intolerance of lay-offs, working conditions, attitudes toward inequality and competition, the credibility of claims to serve a collective interest, or attention paid to the national identity of firms For each country, if we add to these concerns other relevant national traits - such as the nature and status of the public administration - we get a distinctive blend of characteristics that typically proves to be relatively robust or entrenched.

Entrenched characteristics may or may not be embodied or reflected in corporate law, this depending to a large extent on the availability of substitutes outside it. A case in point is the treatment of takeovers. Inasmuch as one of their functions is to "rationalize" production and reduce its cost by laying off personnel, a country in which lay-offs are considered a major nuisance will not be inclined to facilitate takeovers. This

[12] Perhaps rightly so, one must admit. It can be argued that in a world in which most if not all countries grow, it would be unsustainable and inefficient for a single country not to grow also, even in the case where zero growth would be optimal according to the conventional social welfare criteria.

reluctance may be reflected in corporate law and securities regulations. Alternatively, it may have no direct incidence on corporate law or the legal treatment of takeovers but be reflected instead directly in labour law, employment protection and the regulation of layoffs.

To maintain macroeconomic performance, some deep-seated concerns and entrenched characteristics may have to give way or lose their priority. This is usually difficult. The fact that one country accepts to give up some well anchored principle, reflecting a major concern, may help the government of another country to persuade various constituencies and voters in general that similar sacrifices are unavoidable if the economy is to remain "in the race". So far, for reason to which I turn now, this mechanism has not been working very much in Europe and, in any case, the incidence on corporate governance, if any, has been relatively modest.

4.4 Perverse effects

A very important fact, in my view, is that yardstick competition among the governments of the EU member countries has been a major influence over the last decade albeit, on the whole, a negative one. The mechanism has worked perversely. The macroeconomic performance of Germany has been relatively weak, largely for understandable reasons such as the economic burden of unification and the relative disadvantage entailed by European monetary union. Because Germany, and definitely not Britain, is the traditional benchmark used by all to gauge relative performance, the governments of countries such as France and Italy have felt able to relax and accept that their economies does badly also without arising too much concern among voters.[13]

This perverse mechanism has affected domains other than the macroeconomy. The adjournment of reforms considered almost unanimously as necessary in one country is easily mimicked in others under the political pressure of potential losers or of sufficiently influential sectors of public opinion. The reasoning is: if other countries can afford to wait, why could we not wait also? Lately, however, in the press and, to some extent, in public opinion in general, comparisons have turned, within the EU, to countries such as Britain and, outside the EU, to the United States and other continents. The reforms perceived to have enabled the satisfactory performance of the British economy - even if, as noted, that performance is overestimated (because largely due to catching up) - as well as various features of the American economy are becoming inputs in the political debate in Germany itself. In turn, the beginning of reforms in that country has now a significant impact on the political debates in several other member countries and in Switzerland. This change already has important political consequences, observable in particular in the relative popularity of the various leaders and in governments' agenda. Perhaps even more important for our purpose, there is a growing awareness of the need to do something at the level of the European Union. This also can be interpreted as a manifestation of yardstick competition.

[13] The text suggests the presence, to a degree, of an asymmetry in the comparisons. Indeed, there is some empirical evidence that differentials in macroeconomic performance between France and Germany have an effect on votes in the former country but not in the second (Lewis-Beck, Jérôme and Jérôme-Speziari 2001). As noted, a low-performance equilibrium may, however, obtain even in the absence of such asymmetry.

5. Is yardstick competition at a higher level likely to start a centralizing dynamic akin to that of the Single Market?

If, notably in the light of a comparison with the American economy, competition among member countries seems unable to generate sufficient economic growth in the EU as a whole, is it possible that a dynamic akin to that started by the Single Act of 1987 would do the job? This is a serious possibility, I think, even though I will not claim that it is also highly probable. I will present the argument in a schematic way.

(1) Europessimism is back. The performance of the European economy over the last decade has not been satisfactory. Some European countries have done better than others but mainly because they were catching up. Overall, growth has been weak and, in spite of its size, Europe has remained mostly passive, largely dependent in particular on impulsions from outside (mainly the United States) to get out of recessions. These failures -- as well as other dimensions of an actual or looming relative decline such as the emergence of China, possibly followed by that of India -- are increasingly perceived by public opinion, or influential sectors thereof. They are discussed, indeed *ad nauseam*, in the media, in popular books, and in public debates.

The mood today is akin to the widespread feeling of "europessimism" and the related perception of "eurosclerosis" that played a large role in the design and acceptance of the Single Act of 1986 and its "1992" programme. The 2004 elections to the European Parliament reflect in several ways that sentiment.[14]

(2) Europessimism illustrates one ingredient of horizontal yardstick competition, i.e., popular discontent caused by comparisons that reveal the existence of a negative performance gap. The comparisons are first of all with the United States, even though, as noted, accelerated growth on other continents also plays a role. In other words, public opinion, say in France and Italy, is less prone than in the past to look at Germany and more inclined to look (as does public opinion in Germany itself) at the United States and then, with the encouragement of the national governments, to put the blame for the relatively low performance of the European economy on the EU as such.

What may seem lacking at the EU level is the second ingredient of yardstick competition: political pressure on office-holders to act and eliminate the gap. The problem, of course, is the structure of the EU and, in particular, the absence in it of any

[14] As demonstrated by Blanchard (2004), the performance gap between the EU and the United States, in terms of productivity and growth, arose only in the mid-1990s. It is thus quite normal that awareness of the gap is a recent phenomenon. It must also be noted that the performance of Japan has been as weak as that of Europe and that it is only recently that countries such as China, India and Brazil have stopped being considered exclusively as third-world countries and started being perceived by public opinion as major potential competitors. See also in Blanchard (2004) an explanation of the differences this time not in growth rates but in levels of income per capita between the EU and France, on the one hand, and the United States, on the other. One thing suggested by his analysis, I think, is that differences in income levels tend not to become objects of yardstick competition; the difference in income per head between Europe and the United Sates is about the same today as it was in 1970.

electoral contest comparable to the elections that influence policy-makers in democratic countries. It is not clear who the policy-makers are at the EU level, anyhow. But widespread discontent may have an impact on policy-making nonetheless. The way discontent translates into incentives and from there into policy measures is certainly not as transparent in the EU setting than it may be in democratic nation states, but I suggest that to a degree, somehow, and eventually, such translation normally takes place. If this is the case, the inexistence of our second ingredient is more apparent than real. It may not bear, after all, the main responsibility for what looks, so fare, like a weak response of the EU to discontent.

(3) Vertical competition cannot play a large role. Popular dissatisfaction with the EU is not of the same order than discontent with the member states or some of them. In a sense what is expected from the EU is that it makes up for failures of the member states. If the EU were a federation, the fact that discontent is largely addressed to the subcentral level of government - that is, here, to the member states - would offer the EU level a marvellous opportunity to extend its responsibilities and invade policy domains heretofore exploited by the member states alone. Something like the phenomena analysed by Breton (1996) in general and by Roe (2003b) in a particular setting would happen. One might argue that, sometimes, manifestations of vertical yardstick competition of that kind do have an analogue in the EU. In some areas, including corporate law and the regulation of financial markets, the Commission does offer to substitute itself in part to member states. It is not clear, however, that these initiatives reflect a desire to compete. Vertical competition in the European Union is necessarily limited because decision-making in Brussels is not really independent or autonomous vis-à-vis the member states, and also because "Europe is under construction." It is of the essence of the integration process that increasing powers be progressively reallocated to the EU level, not only with the agreement but as the result of the deliberate long-term strategy of the member countries' governments referred to earlier. As a rule, thus, policy-making at the EU level cannot be in a significantly competitive relation with that of the member states. A major exception is the ECJ - and the Commission itself when it has a quasi-judicial function, as is the case with regard to competition .

(4) The comparative advantage of the EU level. To invigorate the European economy, it can be argued that the most important necessary reforms fall into the competences of the member states rather than in those of "Brussels". This explains that the so-called Lisbon Agenda - adopted by a European Council in 2000 and aiming at improving Europe's global competitiveness so that the EU would "achieve a very high level of growth and employment in 2010", to use its phrasing - is above all an exercise in exhortation and has had little effect so far.[15] The new Commission contemplates stronger devices to induce each country individually to do its part in the implementation of the programme, but I doubt that much can be done along that line.

Almost fifty years after the Treaty of Rome, the strength of EU activism remains the same: its raison d'être is in establishing a competitive and integrated internal market, including whatever implications can be drawn from that objective. Thus if

[15] To a degree, the implementation of the Lisbon agenda was intended to work through something like yardstick competition, or at least reform emulation, among member states. For reasons that could be spelled out, this was more or less doomed to fail.

something is to be done at the EU level to foster economic growth, as is perhaps genuinely on the European agenda, the most reliable path to follow remains, like in the mid-1980s, relating all initiatives to the completion and deepening of the common or single market. Fortunately in a sense, the task is far from being fully realized. Fostering more competition in markets that remain segmented (finance, services, etc.), more specialization among member countries, and the emergence of larger transnational European firms so as to benefit from economies of scale remains the set of policies that matches the most closely the economic raison d'être of the EU and is also the most likely to make a distinctive impact on long-term growth.

(5) *Application to corporate governance.* The doubts expressed above about the Lisbon approach have some implications for corporate governance in the EU. Many suggestions and projects, some of them endorsed by the Commission, are defended as means to improve corporate governance. This is the case, for instance, of proposals regarding auditor rotation, off-balance sheet financing, mandatory statements, and the profile of non-executive directors. The motivation underlying these suggestions and projects is typically that their implementation will make the economy more efficient and will contribute, even if only modestly, to enhancing economic growth. Let us assume that better corporate governance will have the latter effect - even though, as argued in Section 4, this is far from obvious. It remains that the efficiency or growth objective is in the spirit of the Lisbon approach and raises the same queries. Inasmuch as law-making can improve corporate governance, and then enhance growth, the member countries can undertake severally to reform corporate law. If they do not introduce the necessary reforms at their own level, it is an illusion akin to those that inspired the Lisbon agenda to think that, as a rule and in a significant way, this introduction will be achieved by decision-making at the EU level.

In other words, if reform proposals are defended only as means to improve corporate governance (admitting that the claim is warranted), they are unlikely to make much headway. European integration does not function in this way, as we saw. Or, rather, it does so only at the margin or in appearance. In contrast, endeavours aiming at eliminating or mitigating features of company law or corporate governance that can be characterized as obstacles to the realization of a competitive and integrated market have a much better chance.

Admittedly, one could argue that diversity across countries with regard to corporate law, auditing, securities regulation and so on, has many advantages. To mention one, now that in the wake of Enron and Parmalat it is difficult to deny that all regulatory systems may fail, and moreover fail in a way which is largely idiosyncratic, diversification across these systems, reducing in this way the "regulatory failure risk", may seem a good idea, in particular from the standpoint of shareholders and fund managers. But, as showed by previous episodes of integration, some of which I alluded to earlier, this kind of argument is not really likely to be deemed relevant in the EU setting. There, what counts is that differences across member countries, whatever their rationale or merits, should be treated above all as impediments to trade and a source of additional transaction costs. They should also be suspected of distorting fair competition among firms and preventing the establishment of a perfect "level-playing field" (Breton and Salmon 2001).

Thus, as in the early 1980s, europessimism (related, as we saw, to a yardstick competition in which the EU as a whole has become engaged) and the perception of an urgent need to do something at the EU level may justify and make pass a new programme of elimination of barriers to trade and distortions of competition, this time possibly in the area we are concerned with - that of commercial law, mergers and financial services. This line is, I think, the most promising that the Commission can use to increase substantially its involvement in these domains.

(6) Beginnings. There are several signs that a first stage of this development is underway. An early indicator is - as was the *Cassis de Dijon* ruling of 1979 that imposed mutual recognition - the recent bold jurisprudence of the ECJ. The *Centros* and subsequent judgments open possibilities for firms to incorporate in member states other than the one in which they have their main activities. This is explicitly authorized by the Court as an implication of the internal market. How far will jurisprudence bring us in the direction of regulatory competition? This is still a matter of controversy, but the signal and the direction are clear. Then there is the *Societas Europeae* - the European company statute - which is currently entering in use and which also offers a means, with some restrictions, to choose one's rules among those in force in different countries. Again, it is difficult to predict the implications of that legal instrument but there is a possibility that the consequences will be important. The remaining signs include the Action Plan of the Commission and other recent initiatives, actions and proposed directives on its part.

(7) Regulatory competition or centralization? Many aspects of the national systems of governance discussed or alluded to earlier, those of France, Germany and Italy in particular, are quite suspect from a perspective focusing on the elimination of all barriers and distortions of competition. Patriotism or nationalism and its implications on the behaviour of government, management and large owners, as in France, or cosy and informal relations within various kinds of national groups and networks, as in Germany and Italy, constitute an obstacle to the full integration of the internal market. In addition, they hinder the process of mergers among firms (including banks) across the borders of member countries, and thus the emergence of a sufficient number of really trans-European large firms. The Anglo-Saxon model of corporate governance, with public firms and diffuse ownership, seems more transparent and, for that reason and others, more compatible with the rules governing in principle the internal market than are the continental models (Gordon 2004). One might be tempted, thus, to imagine that the beginnings just mentioned announce a vast movement of regulatory competition, the generalized adoption of home rather than host regulation, the dismantling of most barriers, the elimination of most distortions, and a convergence toward the Anglo-Saxon model of corporate governance - not because that model is better in some sense but, as Gordon stresses, simply because of the said greater compatibility.

The experience of the Single Act and of the 1992 programme suggests that such outcome is unlikely. Countries such as France, Germany and Italy will probably build up a coalition that will impose a compromise between the safeguard of many of the principles entrenched in their societies on the one hand, and the need to facilitate mergers across their borders and to allow more competition and integration in those

sectors of activity that have remained relatively segmented, on the other. An example is takeover law, or more generally the regulation of mergers. Most of the governments in continental Europe will be wary of letting takeovers and mergers entail unprotected or non-negotiated lay-offs, involving large numbers. These governments will make sure that transformations in the legal framework will not lead to such outcome. If the said transformations were to be expected as an effect of regulatory competition, and if - for instance because of ECJ judgements - governments could not block or limit that competition by the use of their own regulatory or law-making power, then they would seek a solution in the form of centralization at the EU level.

As with the implementation of the Single Act, the most comfortable way to eliminate impediments to an integrated market while safeguarding regulation is to accept substantial centralization at the EU level - if necessary with some possibility of opting-out. Because many of the concerns dominant in France, Germany and Italy are shared by some of the other member countries, and because these three countries have a weight which renders their priorities influential in the processes of issue-linkage and position-trading that precede any major decision in the EU, it is probable that the rules that will emerge at the EU level will not converge toward those in force in the United States or Britain but will present a distinctive European or "continental European" character. As many other outcomes of the usually tortuous processes that lead to decisions in the EU, these rules will not necessarily be those that optimal design or scholarly discussion would have recommended.

6. Conclusion

Regulatory competition in the area of corporate law is becoming a topical issue in the context of the European Union as it has been for some time in that of the United States. The approach underlying our discussion of the matter has been based on the presupposition that, in democracies, voters count. Their influence is felt in all sectors of public policies. This applies to corporate law-making as to other domains. Voters, however, are in a situation of information asymmetry. The possibility of comparing the performance of their own government with that of others mitigates the informational difficulties they face. These comparisons have an effect on office-holders' incentives and decisions and generate a situation of yardstick competition among governments - a form of competition that must be taken into account together with the better known form based on the cross-border mobility of individuals, firms and capital. In the case of corporate law, however, the role played by yardstick competition will typically be indirect.

I have tried to show that the particular intensity, among member countries of the EU, of yardstick competition over macroeconomic variables may account for economic growth in these countries converging in the long run in spite of their systems of corporate governance being quite diverse and, under some criteria, of uneven quality. I have also argued that, over the last decade or so, yardstick competition within the EU has had a perverse effect, leading to a low-performance equilibrium.

In contrast, yardstick competition between the EU as a whole and other parts of the world, the United States in particular, seems able to have a positive effect on the rate

of economic growth in Europe. That possibility, however, must be discussed in the context of the peculiar path followed by European integration and the idiosyncrasies of EU decision-making. One feature of the EU system, as it works in practice, is pervasive recourse to issue-linkages and intergovernmental bargaining. This entails that entrenched preferences of member countries are seldom bypassed, even when formal decision-making rules could allow it. Another characteristic is that the comparative advantage of decision-making at the EU level rather than at the level of each member country still lies, as it has always done, in the task of drawing and implementing all the implications of the internal market commitment.

Some of these implications concern us directly. Differences in corporate law and governance across member countries will typically be interpreted as a source of additional costs for transactions across borders as well as an obstacle to perfectly fair competition among firms. In other words, they will be interpreted as not fully consonant with a fully integrated and competitive internal market. If the EU as such is to play a role in the effort (induced by yardstick competition with the outside world and involving first of all the member states) to enhance economic growth in Europe, and if, for this role to be credible, the EU concentrates on the internal market, this may justify EU policies aiming at reducing differences in corporate law or, more generally, in the legal environment of business firms. These policies will be constrained, however, by the entrenchment of voters' preferences. I have tried to show, consequently, that the dynamic entailed is more likely to lead to centralized regulation than to deregulation or enduring regulatory competition, and may well end up in a distinctive legal environment for firms doing business in Europe. This outcome will have to be sustainable, notably in its ability to allow macroeconomic performance at the level required by competition with the outside world. But, as is usual with EU arrangements, judging it in terms of efficiency or optimality will be largely irrelevant.

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Table 1. Legal origins and performance, 16 European countries

European countries extracted from Gugler, Mueller and Yurtoglu (2004, Table 3)*	Marginal *q*	GDP growth 1960-92
Britain	0.85	2.27
Ireland	1.10	4.25
English-origin average	**0.98**	**3.26**
Denmark	0.65	2.09
Finland	0.96	2.40
Norway	1.04	3.43
Sweden	0.65	1.79
Scandinavian-origin average	**0.83**	**2.43**
Austria	0.71	2.74
Germany	0.57	2.60
Switzerland	0.64	1.18
Germanic-origin average	**0.64**	**2.17**
Belgium	0.51	2.46
France	0.57	2.54
Greece	0.54	2.46
Italy	0.64	2.82
Netherlands	0.69	2.55
Portugal	0.46	3.52
Spain	0.54	3.27
French-origin average	**0.56**	**2.80**
General average 16 countries	**0.70**	**2.65**
(United States)	**(1.05)**	**(2.74)**

* Luxembourg is excluded because its GDP growth rate is not indicated in the original table.

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