17 Regulatory Competition and Coordination

Regulatory competition involves the competitive adjustment of regulatory regimes in order to secure some advantage.[1] Regulators, indeed, can be seen as potential competitors in offering (or 'selling') a product, namely a regulatory regime involving standards, information-gathering, and enforcement activities. Competitions, moreover, can operate on a number of fronts. Regulators can lower standards, for example, so as to make compliance relatively easy and cheap for industry. Equally, they can court potential regulatees by offering more attractive styles of regulation than competitors (e.g. incentive- rather than command-based systems) or they can offer more assistance and advice than their competitors. They can operate procedures that are more amenable to regulatees and allow greater accessibility, transparency, or fairness. Alternatively, they might seek to persuade regulatees that their regimes will be more certain than the available alternatives (because they eschew goalpost moving) or that they have greater expertise than competing regulators and will be able to offer superior leadership and organizing capacity when changes have to be adapted to.

Regulatory competition, however, is associated with certain concerns. The idea that regulators and jurisdictions compete on the basis of regulatory standards or matters of broader 'regulatory environment', such as corporate governance requirements, tax levels, and environmental standards, is often used to highlight the dangers of a lack of national or international coordination. It is often suggested that processes of competition will lead to an inevitable race to (undesirably) low levels of regulation that undermine social or environmental standards. One specific accusation has been that in an age of mobile production systems, firms will exploit loose regulatory frameworks and move to those jurisdictions that offer them the least burdensome regulation. It is thus

[1] See generally: J.-M. Sun and J. Pelkmans 'Regulatory Competition in the Single Market (1995) 33 *Journal of Common Market Studies* 67–89; C. Radaelli, 'The Puzzle of Regulatory Competition' (2004) 24(1) *Journal of Public Policy* 1–23; J. Braithwaite and P. Drahos, *Global Business Regulation* (Oxford, 2000), chs 21, 24; W. Kerber and R. Van den Bergh, 'Mutual Recognition Revisited: Misunderstandings, Inconsistencies, and a Suggested Reinterpretation' (2008) 61 *Kyklos* 447–65; J. Pelkmans, 'Mutual Recognition in Goods: On Promises and Disillusions' (2007) 14(5) *Journal of European Public Policy* 699–716; F. Scharpf, 'Negative and Positive Integration in the Political Economy of European Welfare States' in G. Marks et al., *Governance in the European Union* (London, 1996), 15–39; S. Vogel, 'International Games with National Rules: How Regulation Shapes Competition in "Global Markets"' (1997) 17 *Journal of Public Policy* 169–93.

suggested that firms can often threaten to exit from regulatory regimes and can thereby persuade governments either to regulate lightly or to offer other kinds of side-payments in order to avoid negative outcomes and, in particular, any associated job losses. A particularly prominent charge has been that regulatory competition contributed to the financial crisis of the late 2000s. US banks, for example, were accused of 'venue-shopping' between different regulators who sought to please their regulatees in order to maintain their regulatory 'businesses'.[2] Similarly, the German banks that required financial bailouts in the late 2000s were said to have been largely driven into their financial distress by the 'off-balance sheet' operations of subsidiaries, many of whom were operating in 'light-touch' regulatory environments such as Ireland.[3] The collapse of the former insurance giant AIG was at least partly triggered by that firm's dealings at its London office—which enjoyed lighter oversight than it experienced in the US.[4] It can also be noted that changing EU regulations led Ireland to relax its local rules on hedge funds in order to battle Luxembourg for the position as 'location of choice' for onshore hedge funds in 2010.[5]

These are a few examples of negative developments that can be associated with regulatory competition. Whether such worries about regulatory competition are well-founded is one issue to be dealt with in this chapter. It commences by outlining the emergence of the term 'regulatory competition' and noting arguments in its favour. The discussion then moves to a wider argument, namely whether there is evidence of a 'race' between jurisdictions and, if so, whether such races tend to take a particular direction.

Regulatory Competition—and its Prerequisites

The origins of the regulatory competition debate are usually associated with the so-called 'Delaware effect'. This phenomenon was associated with competition among US states regarding company law (US states are legally required to recognize other states' charters). The state of Delaware put into effect particularly modernized incorporation statutes that consequently led a considerable number of New York listed firms to move to incorporation in Delaware—a shift that drove mirroring statute changes in a series of other

[2] C. Provost, 'Another Race to the Bottom? Venue Shopping for Regulators in the American Financial System', paper presented at the 3rd Biennial Conference of the Standing Group on Regulatory Governance, Dublin, 17–19 June 2010.

[3] 'Hypo-Retting könnte Steuerzahler über 50 Milliarden Euro kosten', *Spiegel Online*, 5 Oct. 2008 (http://www.spiegel.de/wirtschaft/0,1518,582251,00.html, last accessed 8 Dec. 2010).

[4] 'AIG Trail Leads to London "Casino"', *Daily Telegraph*, 18 Oct. 2008.

[5] 'Dublin Entices Funds with Softer Regulation', *Financial Times*, 6 Sept. 2010.

states.[6] The so-called Delaware effect is thus associated with an uncoordinated adjustment or 'race' across states that involved a 'downward' adjustment in regulatory standards (in this case, making chartering requirements particularly attractive to management).[7]

The debate concerning regulatory competition, especially its normative justification, is linked to Charles Tiebout's contribution on the appropriate size of municipal governments.[8] In opposition to those who argued in favour of large municipal areas, Tiebout offered a model of (small-scale) municipal government that suggested that city managers should attract 'consumer-voters' with particular local expenditure patterns that would please different sets of preferences. This was a theoretical argument that suggested that voters would vote with their feet in the way that consumers might choose the market stall for their daily vegetable shop. Consumer-voters (his term) would favour jurisdictions that best reflected their preferences: some would opt for low tax/low public service destinations, others would pay more for lifeguards on beaches, whilst others would prefer the provision of good schools. Municipalities offer so-called club goods (or 'toll goods'); they are 'public goods' until the time when crowding occurs and individuals can be excluded from their consumption. As a result, every jurisdiction is said to have an optimal size, and communities will seek to attract new residents up to the optimal point to reduce the average cost of providing services.

There are five prerequisites for the 'voting with your feet' effect. These are: that (1) consumer-voters are fully mobile; (2) consumer-voters are fully aware of the different 'bundles' on offer; (3) there is a large number of communities to choose from; (4) there are no restrictions on employment; and (5) there are no externalities.[9] It is clear from these five prerequisites that this is largely a model of heuristic value that informs wider debates about the benefits or otherwise of relying on decentralized governance structures.[10] In particular,

[6] J.A. McCahery and E.P.M. Vermeulen, 'Does the European Company Prevent the "Delaware-effect?"', TILEC Discussion Paper No. 2005–010 (2005) (available at SSRN: http://ssrn.com/abstract=693421 or doi:10.2139/ssrn.693421), esp. pp. 8–10.

[7] Some, however, argue that regulatory competition can in fact lead to a 'race to the top' in some areas of corporate law. L. Bebchuk, A. Cohen, and A. Ferrell, 'Does the Evidence Favor State Competition in Corporate Law?' (2002) 90 *California Law Review* 1775–821.

[8] C. Tiebout, 'A Pure Theory of Local Expenditures' (1956) 64 *Journal of Political Economy* 416–24. Also (for a critical comment) W. Bratton and J. McCahery, 'The New Economics of Jurisdictional Competition' (1997) 86 *Georgetown Law Journal* 201–78; J.P. Trachtman, 'Regulatory Competition and Regulatory Jurisdiction' (2000) 3(2) *Journal of International Economic Law* 331–48; W.E. Oates, 'Fiscal and Regulatory Competition' (2002) 3(4) *Perspektiven der Wirtschaftspolitik* 377–90.

[9] Tiebout, C. 'A Pure Theory of Local Expenditures', 419.

[10] Tiebout noted the limitations of the argument and noted that where 'external economies and diseconomies are of sufficient importance, some form of integration may be indicated' (Tiebout, 'A Pure Theory of Local Expenditures', 423; see also R. Imman and D. Rubinfeld, 'The Political Economy of Federalism' in D. Mueller (ed.), *Perspectives on Public Choice* (Cambridge, 1997). See also the discussion of 'polycentricity' in Chapter 18. Generally, Tiebout, together with Vincent Ostrom

transaction costs of moving are never zero, and the assumption that customer-voters live on 'dividend income' instead of having a job is arguably heroic. The important idea, however, is that consumer-voters choose which governments satisfy their set of preferences best.

In relation to regulatory competition, the key prerequisites remain the same; it is still assumed that there is an optimal size of jurisdictions, that the supply of jurisdictions is perfectly elastic, that mobility is costless, that households and firms are fully informed (about standards and enforcement), and that there are no inter-jurisdictional externalities.

Advocates of regulatory competition therefore suggest that 'exit' should be facilitated to restrict the potential power of government, and competition would be facilitated by allowing for a choice of legal rule.[11] Challenges to the assumptions underlying this particular view of regulatory competition are numerous. One relates to the idea of costless freedom of movement, especially across jurisdictions. Indeed, it is likely that only some actors are able to move freely—for example, mobile capital faces fewer difficulties in moving than labour, leading to inherent power asymmetries. Second, there is the criticism that rationality is inherently bounded and that information will never be 'complete'—which places constraints on both regulator and regulatee decision-making. Third, there are evident limits to the argument about 'optimal size' of jurisdictions that relates to externalities: some issues clearly call for a cross-border inter-jurisdictional regulatory approach (for example, pollution, where 'scale' matters); regulatory approaches in one jurisdiction are likely to impact on other jurisdictions, and what exactly constitutes a significant externality (i.e. one that is regarded as deserving political attention) is mostly a matter of political and societal preferences, rather than a clear-cut economic calculus. Fourth, there is only modest evidence that there is a 'perfectly elastic supply of jurisdictions'. Overall, it can be said that limits on the extent to which it is possibly to realize a 'pure' Tiebout world mean that the degree to which Tiebout-type regulatory competition can lead to superior efficiency can be questioned.[12]

and Robert Warren, pointed to the potential superiority of polycentric over centralized decision-making, especially for public services. Small and medium-sized municipalities were more effective than large cities in monitoring performance and cost, citizens were able to 'exit' if they were dissatisfied and 'vote with their feet', and and there was greater autonomy of local decision-makers in decentralized systems (see also V. Ostrom, C. Tiebout, and R. Warren, 'The Organization of Government in Metropolitan Areas: A Theoretical Inquiry' (1961) 55 *American Political Science Review* 831–42.

[11] A. Hirschman, *Exit, Voice and Loyalty: Responses to Decline in Firms, Organisations and States* (Cambridge, MA, 1970).

[12] Trachtman, 'Regulatory Competition and Regulatory Jurisdiction', 338; W. Kerber and R. Van den Bergh, 'Mutual Recognition Revisited: Misunderstandings, Inconsistencies, and a Suggested Reinterpretation' (2008) 61 *Kyklos* 447–65.

The Effects of Regulatory Competition

As noted, the Tiebout-informed view of regulatory competition is one that advocates decentralized decision-making. It therefore argues that there are significant advantages in taking regulatory decisions at the lowest level possible. Regulators will seek to attract the 'optimal' number of regulatees and will be responsive to their demands because they fear 'exit' or a 'voting with their feet' response. Regulators, accordingly, are forced into a responsive 'race to the top', involving regulatory rules, processes, and enforcement practices that are responsive to citizen-consumers and regulatees.[13] In addition, advocates of regulatory competition stress a number of its advantages. The first of these is *responsiveness*. Regulators will seek to respond to changing environments and demands in order to prevent 'exit'. They are also less likely to be captured by particular interests, as the result of capture may be an exit by affected constituencies. Regulatory competition therefore puts constraints on the Leviathan-character of regulators and governments. Furthermore, responsiveness is also likely to reduce regulatory complexity created by centralized and harmonized regulation. A second posited advantage of regulatory competition is *diversity and choice*. Consumers and regulatees will be able to choose between different 'bundles' of regulation. Regulation therefore is 'tailored' to the needs of specific economies, constituencies, and sectors of demand. A further positive aspect of competition is *innovation*. Decentralized systems that are in competition with each other are said to encourage market-driven innovation and discovery processes. Finally, competitions between regulators are said to encourage *responsiveness* to local needs and concerns rather than to produce the 'lowest common denominator' of different regulatory interests and challenges.

Against these supposed advantages of regulatory competition can be placed a number of concerns. In the first instance, the Tiebout-informed world of regulatory competition assumes, as noted, costless mobility, adequate information regarding regulation, and that enforcement is predictable. Exit (and voice) need to be available to all parties so that regulatory regimes can be responsive. A more critical look at these assumptions, however, raises considerable problems, and suggests that the overall effects of regulatory competition are likely to be negative. One (already mentioned) point is that some actors are more likely to be able to move freely than others.[14] This means that the

[13] See also R. Romana, 'Is Regulatory Competition a Problem or Irrelevant for Corporate Governance' (2005) 21 *Oxford Review of Economic Policy* 212–31.

[14] On this basis, Streeck and Schmitter have made an argument about the power of internationally moving capital over nationally fixed labour markets, suggesting that in a world in which states have lost boundary-control over their national economies, states are required to be responsive to business but not labour, therefore challenging welfare states (W. Streeck and P. Schmitter, 'From National Corporatism to Transnational Pluralism' (1991) 19 *Politics and Society* 133–64.

threat of moving will often be sufficient to persuade regulators (and governments) to grant 'benevolent' regulatory treatment to these highly mobile actors, rather than to those that are unlikely to move or incapable of moving. Thus, local governments or regulators will listen more readily to highly mobile large firms than to residents who are unlikely (unable) to move. In the wider context, it has often been suggested that 'voting with your feet' will mostly benefit the mobile and wealthy and that 'voting with your feet' is likely to compound socio-economic inequality. Rich consumer-voters will move to and congregate in low-tax, well-serviced areas, and poorer individuals will be left to inhabit jurisdictions that are too hard-pressed to provide high levels of service.[15] A related fear is that governmental policies are skewed by decisions to compete on certain fronts rather than others. Thus, one of the key worries about structures, such as the EU Single Market and its mutual recognition principle, is that it encourages an emphasis on regulatory competition in favor of economic over social and/or environmental interests.[16]

A further concern relates to the issue of externalities and the problem of overlapping and unpredictable application of regulatory approaches. Voters in jurisdiction A may have 'voted with their feet' for high regulatory environmental standards, but jurisdiction B may offer 'low' environmental standards, and the pollution allowed in jurisdiction B may cross the border and afflict jurisdiction A. The result is that jurisdiction A will still suffer from high pollution as a result of the choices made in jurisdiction B. Where regulation in one area is poorly organized or slack, moreover, it might have wider systemic effects. A banking crisis in one particular jurisdiction, for instance, may still cause a run on banks in another, even if the latter jurisdiction's regime is said to be stable and functioning. Finally, this is a world where material self-interest through the 'exit' option and not through political processes decides on regulatory standards. This may offend some observers who believe in ideas of liberal-democratic accountability.

The Tiebout-world also gives rise to the more general worry that it can produce inherent instability, with regulatory regimes constantly adjusting to mimic and outdo each other. This leads to the suggestion that such instabilities will require 'centralized' regulation or the application of other means to achieve coordination.[17] This instability is said to encourage particular 'races' between jurisdiction (a topic we will consider in the next section) and, even if races do not occur, the fear is that regulators will not be able to offer 'stable' packages of regulatory regimes. Rather, what would emerge is a

[15] See P. Self, *Government by the Market?* (Basingstoke, 1993).

[16] For a discussion of the pros and cons of mutual recognition in EU goods markets, see J. Pelkmans, 'Mutual Recognition in Goods: On Promises and Disillusions' (2007) 14 *Journal of European Public Policy* 699–716.

[17] Trachtman, 'Regulatory Competition and Regulatory Jurisdiction', 339; Bratton and McCahery, 'New Economics'.

broadly directionless regulatory regime that would be forced to adjust to outside pressures.

The main attraction of the Tiebout model has been its heuristic value. The wider literature on 'polycentricity' has highlighted the varied nature of ways in which social systems can achieve desired outcomes and has highlighted the varied ways in which governance systems that go beyond states and markets (i.e. including regulatory regimes) can be set up. In the end, there may be no simple and universal conclusion on the advantages or disadvantages of encouraging regulatory competition; the calculations will rather depend on particular constellations. Indeed, the debate about regulatory competition is arguably leading to a much wider debate about the appropriate level of jurisdiction; we return to this discussion in Chapter 20.[18]

Races to the Bottom and to the Top

Regulatory competition is widely associated with two key ideas. The first is the notion of the 'race to the bottom', in which jurisdictions are in a 'prisoner dilemma'-type constellation that drives them to adopt ever-decreasing regulatory standards to attract mobile factors of production. In this world, regulators compete by relaxing regulation and indulging in such practices as reducing social or environmental standards, applying loose enforcement practices, or implementing other steps to offer a 'light-touch' environment. In this context, having stricter social and environmental standards becomes a source of cost and competitive disadvantage. Labour costs rise if social obligations are imposed, and measures to reduce emissions are similarly seen as merely raising the costs of production.

The opposite race—'to the top'—is said to exist where jurisdictions move to higher standards that they would not have adopted if it had not been for the presence of rival jurisdictions.[19] This process has also been termed the 'California effect' by the political scientist David Vogel.[20] According to Vogel, competing regulatory standards can lead in some cases to a 'race to the top', as in the case of environmental emission standards for cars in the US. He observed that California's adoption of tight environmental standards for cars was quickly followed by other US states, and led to a harmonization at

[18] See Trachtman, 'Regulatory Competition and Regulatory Jurisdiction', 333.

[19] We ignore here the kind of regulatory 'race to the top' that emerges in the context of moral panics and media-feeding frenzies. In these situations, politicians, on heat to regulate in response to public pressure, demand the 'toughest law'.

[20] D. Vogel, *Trading Up: Consumer and Environmental Regulation in a Global Economy* (Cambridge, MA, 1997).

a higher level that formed the basis for the next round of minimum federal requirements.[21] The underlying dynamic here is that producers, when faced with segmented markets, will demand the adoption of common standards to reduce production costs. Thus, stricter regulation represents a source of competitive advantage for domestic producers, while richer countries, more likely to have higher environmental standards, are likely to force importers to adjust to these standards to guarantee continued market access. In addition, international agreements allow richer countries to facilitate access to rich markets *in exchange* for agreement on stricter standards.[22] The California effect, therefore, suggests that domestic producers do not have a narrow interest in 'loose' regulation; rather, they will demand a 'level playing field' in terms of similarly strict regulatory standards elsewhere. Should they be successful, they face no adjustment costs, whereas their competitors in other jurisdictions will be required to alter their products, thereby incurring considerable compliance costs. Vogel also notes why, therefore, EU environment standards have been higher rather than lower: the higher standards reflected the interests and the domestic rules facing German producers. The self-interest of industry therefore coincides with environmentalist or 'green' interests, leading to the emergence of so-called 'baptist–bootlegger' coalitions.[23]

A 'race to the top' may drive regulatory standards and rigour to higher levels, but this does not necessarily mean that the race will be to the 'optimal' regulatory regime—where the optimal comprises the level of standards and enforcement rigour that coincides with the preferences of an informed body of consumers or an informed electorate. If information is imperfect, or influences over regulators are weak, the 'race to the top' may lead to supra-optimal regulation where, for instance, the standards applied are higher than are justified (as where airline security controls are too risk-averse) and the consumers of services will be ill-placed to evaluate the costs and benefits of regulatory measures or to bring excessive levels of control down to acceptable positions.

[21] Ibid., 259.

[22] Ibid., 259–60.

[23] The term 'Baptist–bootlegger coalition' emerged in the context of demands for prohibitions on alcohol sales on Sundays. Baptists demanded the prohibition of the selling and drinking of alcohol on Sundays on moral grounds. Bootleggers wished alcohol sales to be illegal so that they could maintain their business (i.e. they demanded sales restrictions, not a prohibition on drinking alcohol). Politicians advocating sales restrictions were therefore in the enviable position of being able to endorse moral arguments while pocketing contributions from the bootleggers. Conveniently, the Baptists acted as 'information gatherers' to monitor compliance of the restrictions that are advantageous to bootleggers. Overall, as noted in Chapter 4, the 'Baptist–bootlegger' theory of regulation represents a contribution to interest group accounts on the lines of George Stigler and Sam Peltzman. It suggests that for regulatory advocacy to be successful, it requires concentrated industry interest and successful 'moral' rhetoric (the 'locus classicus' for the 'Baptist–bootlegger coalition' term is B. Yandle, 'Bootleggers and Baptists: The Education of a Regulatory Economist' (1983) 7 *Regulation* 12–16.

The broad distinction between 'races to the top' and 'races to the bottom' has given rise to further discussions of the areas of regulation that are likely to experience particular types of races. Jurisdictions can be engaged in different regulatory races at the same time. One key distinction here lies between product- and process-type regulation.[24] *Product standards* are those that change the qualities of a product. They provide, for example, for more energy-efficient freezers or less polluting cars. Diverse product standards, furthermore, also segment markets. It is, therefore, these kinds of regulatory standards that are more likely to witness a 'race to the top'. Consumers in rich countries are willing to pay 'extra' to feel good about purchasing a 'better' product. They will thereby place pressure on producers to deliver these higher standard products.

Product standards have two effects that encourage harmonization at a higher level: they have a certification effect (in that consumers receive a visible sign that they are consuming a superior good) and, more importantly, they are 'market-making' and 'market-enabling' in that they reduce production costs between segmented markets. Industries in 'low-regulation' jurisdictions with interests in accessing 'high-regulation' markets, therefore, have self-interests that are served by producing to the higher standard.[25] The interest in homogeneous standards, of course, has its limits when it comes to those standards associated with high fixed asset and switching costs (such as electronic sockets).

None of these self-reinforcing mechanisms exists in the case of *process standards*. These standards merely enhance the costs of production without altering the quality of the product as such. A process standard, therefore, is neither market-making nor has it an inherent certification effect. Male truckers, for example, are not rendered more competitive as a result of higher fuel taxes or provisions that reduce working hours or establish more extensive paternity leave rights than in neighbouring jurisdictions with lower standards. The same logic, however, does not necessarily apply to service industries. In this case, the services rendered (i.e. the processes of providing particular services) constitute the products, and these, therefore, can in some way be regarded as 'certifiable'.[26] It is therefore possible that process standards in particular industries can be linked to the possibility of a 'certification effect'. It might be possible to observe 'races to the top' in some cases.

In general, though, process standards are more likely to experience a 'race to the bottom' due to their 'market-correcting' nature. Producers have the

[24] Scharpf, 'Negative and Positive Integration', 15–39; C. Radaelli, 'The Puzzle of Regulatory Competition' (2004) 24 *Journal of Public Policy* 1–23.

[25] Ogus therefore talks of 'facilitative' regulation that is market-making, A. Ogus, 'Competition between National Legal Systems: New Insights for Comparative Law?' (1999) 48 *International and Comparative Law Quarterly* 1–14.

[26] Similarly, higher safety rules may, in some cases, be regarded as having a 'certification effect'.

incentive to move to the jurisdiction that offers the lowest process standards, thereby putting pressure on other jurisdictions to adjust their social and environmental process standards downwards. As a result, federal states usually have national rules that apply to process- or market-correcting regulation. Such structures do not exist in the European or international economy. This leads to the fear that the internationalization of economies (and the enhanced mobility of particular factors of production which combine to reduce the national 'boundary control' over economic regulation) will lead to a 'race to the bottom' in the case of process standards.[27] While producers in 'high-regulation' jurisdictions might have an interest in exporting their high process standards to low-cost jurisdictions, there are no incentives for the low-cost producers to accommodate these demands.

When comparing the empirical results, it is very difficult to establish conclusive evidence that regulatory jurisdictions are engaged in extensive races. There are some signs, as illustrated above, that environmental standards have witnessed something of a 'race to the top', following the logic of 'market-making/enabling regulation'. There has, however, been little sign of an explicit race to the bottom. Instead, racing has been prevented by the introduction of process regulation (or market-correcting regulation). These measures were usually effected on the basis of lowest common denominator bargaining, taking the form of minimum standards. They usually also involve side-payments from 'high-regulation' to 'low-regulation' countries (as 'high-regulation' jurisdictions also face political opposition against any potential lowering of standards). The same pattern emerges from extensive studies of 'mutual recognition' in the context of the European Union. The broad idea—that goods being sold according to the regulations of any member state can be marketed in principle in all other member states[28]—seems to endorse notions of regulatory competition and has led to fears about 'races to the bottom'. Studies, however, suggest the limits of the mutual recognition principle—so-called 'equivalence' must be observed and member states have defined objectives and prescribed minimum standards. Indeed, the European world of mutual recognition has so far been one of 'mediation'.[29] Similarly, studies of US regulatory enforcement in environmental regulation have not found a clear-cut 'race to the bottom' trajectory, although regulators are said to

[27] F. Scharpf, 'Balancing Positive and Negative Integration', *MPIfG Working Paper* 97/8 (Cologne, 1997) (http://www.mpifg.de/pu/workpap/wp97–8/wp97–8.html); F. Scharpf, 'What Have We Learned? Problem Solving Capacity of the Multi-level Polity', *MPIfG Working Paper*, 01/4 (Cologne, 2001) (http://www.mpifg.de/pu/workpap/wp01–4/wp01–4.html)

[28] S. Schmidt, 'Mutual Recognition as a New Mode of Governance' (2007) 14 *Journal of European Public Policy*, 667–81, esp. 667.

[29] Ibid., 677; also J. Pelkmans, 'Mutual Recognition in Goods: On Promises and Disillusions' (2007) 14 *Journal of European Public Policy* 699–716; and A. Heritier, 'Mutual Recognition: Comparing Policy Areas' (2007) 14 *Journal of European Public Policy* 800–13.

interact strategically with each other. They do, however, respond in their enforcement practices to perceived disadvantages that arise from the enforcement practices of their competitor jurisdictions. Equally, however, and supporting a 'race to the top' argument, regulators seem to be adjusting their enforcement 'upwards' in interaction with their competitors.[30]

This discussion suggests that the 'racing' analogy has important implications for the study of regulation.[31] The indications, however, are that it is far less prevalent than many observers have suggested. Of course, the potential of 'exit' and regulatory competition means that regulators may anticipate exit and therefore adjust their regulatory standards, processes, and enforcement practices. It is difficult, though, to estimate how extensive this process of adjustment is. Instead, 'races' are inherently limited because of the stickiness of national politics. Taking steps to reduce regulatory standards in social protection, for instance, is unlikely to be electorally popular (although reducing environmental regulatory compliance cost to attract major investment and employment opportunities could be attractive to voters) and key 'protective' interests have arguably some degree of 'veto power' in national legislative processes. Indeed, states may not wish to attract polluting industries; instead, they may wish to encourage particular industries by signalling their commitment towards a 'clean' environment through tough environmental regulation. This suggests that 'races' are hardly straightforward and that regulators and jurisdictions have to weigh competing interests. Indeed, it is not always clear what exactly constitutes 'top'- or 'bottom'-level regulation. Commentators on regulatory races often assume that there is a normative position about what 'optimal' means. What 'optimal'-level regulation looks like in a given context, however, is inherently contested.[32]

Regulatory Coordination

The threat of a 'race to the bottom' as well as the realization that some problems require cross-jurisdictional approaches has prompted considerable

[30] D. Konisky, 'Regulatory Competition and Environmental Enforcement: Is There a Race to the Bottom?' (2007) 51 *American Journal of Political Science* 853–72. Also N.D. Woods, 'Interstate Competition and Environmental Regulation' (2006) 86 *Social Science Quarterly* 792–811; A. Prakash and M. Potoski, 'Racing to the Bottom? Trade, Environmental Governance, and ISO 14001' (2006) 50 *American Journal of Political Science* 350–64.

[31] J. Braithwaite and P. Drahos, *Global Business Regulation* (Oxford, 2000), chs. 21, 24.

[32] C. Radaelli, 'The Puzzle of Regulatory Competition' (2004) 24 *Journal of Public Policy* 1–23. When considering investment decisions and the business friendliness of different jurisdictions, it should be noted that the costs of regulatory compliance may only be a limited factor in decisions about investment locations—see Vogel, *Trading Up*, 142.

debates regarding the possibilities and potential of regulatory coordination. Coordination, 'joined-up regulation', or other terms are used to advocate greater harmonization of approaches. At the same time, coordination is also about controlling processes (to make them more harmonious)—and therefore inherently about political strategies. Calls for coordination are, in practice therefore, usually associated with the political desire to eliminate the perceived advantages of competing jurisdictions.[33]

Coordination can occur horizontally and vertically. Different forms of coordination can be imagined, ranging from loose interaction, an emphasis on joint professional norms among regulators, the adoption of common methodologies, to the outright formal merger of regulatory regimes. We address this particular debate in Chapters 8 and 18 in looking at regulatory mixes and multi-level governance, respectively. In such discussions, central issues are how regulatory networks can be coordinated and how different coordinating approaches can impact on outcomes. For present purposes it suffices to set out two key arguments in favour of coordination.

The first argument stresses the importance of cross-sectoral or cross-jurisdictional overlap. For example, some 'bads' or regulatory concerns are of a trans-boundary or cross-sectoral nature and require a regulatory approach that addresses the cross-boundary aspect of this particular problem. For example, pollution often calls for cross-jurisdictional regulation, since it can be externalized across boundaries (as when one country's poorly regulated factory pollutes the air that drifts into another country). Similarly, industries sometimes demand reduced compliance costs through a harmonized regulatory approach when operating in a different or even the same market. For example, if industries are increasingly operating both in electricity and gas retail markets and when there is a degree of substitution between these two goods, an argument can be made that regulators should take a unified approach to these goods as they are competing in the same market. A similar argument has been made in the context of converging communications regulators. Here the argument has been that as telecommunications, broadcasting, and other forms of communications can no longer be seen as separate industries, this requires a regulatory merger to reflect a converging market. Cross-sectoral approaches to regulation through the merger of separate regulators can also be advocated in terms of organizational cost and resources. Especially in those contexts where regulatory staff resources are thinly spread, it makes sense to concentrate resources in one regulatory body, thereby concentrating expertise and encouraging consistency of regulatory approach at the same time.

[33] S. Gadinis, 'The Politics of Competition in International FInancial Regulation' (2008) 49 *Harvard International Law Journal* 447–508.

The second argument in favour of coordination points to the potential costs of a lack of coordination. Most of these suggested costs relate to the debate on regulatory competition and the possibility of a 'race to the bottom' and its impact on fairness. As noted in the context of the EU, member states have been careful to protect themselves against 'racing' by agreeing on minimal standards, even though, at times, these take on the character of lowest-common-denominator bargaining. Similarly, coordination is advocated in the face of explicit industry gaming, such as when industries strategically exploit regulatory and other (such as tax) loopholes by shifting particular activities across different jurisdictions.

Whatever the potential advantages of regulatory coordination, any attempt to achieve regulatory coordination is neither problem-free nor cost-free. Regulatory bureaucracies, like all bureaucracies, are keen to protect their own turf. Different professions have different views on what is important and how to deal with particular problems. Industry too may resist coordination if this decreases their opportunities to exploit fragmented regulatory regimes. Indeed, how many resources should be placed into achieving coordination depends on fundamental questions regarding the extent of coordination sought to be achieved. The less tolerant we are of diversity, the more resources will have to be spent on information-gathering and behaviour-modification. Indeed, considerable effort and cost will have to go into agreeing the detailed standards supposedly guiding the regulatee's behaviour. Compromise, especially when conducted between jurisdictions, is more likely to lead to somewhat looser agreements, unless powerful interests offer considerable side-payments.

Conclusion

Regulation is a key part of any country's or region's competitiveness. How regulators go about their business, what kind of standards they set, and how they interact with regulatees matters fundamentally. The idea of regulatory competition is, therefore, powerful and relevant. Pressures to compete and to coordinate approaches are imposed on regulators at the sectoral, domestic, and international levels. The extent to which regulatory competition in the form of Tiebout-type processes is feasible, and to what extent it is desirable, depends on a number of factors. Coordination similarly can be both of a beneficial and of a detrimental nature. In this chapter we have emphasized the importance of understanding the heuristic value of the Tiebout-model for encouraging debates about regulatory competition and its desirability. We have also sought to highlight the limited extent to which regulatory competition has led to straightforward empirical trends. More fundamentally, the extent to which regulatory competition is regarded as a potentially benevolent or, more likely, malevolent force depends on whether we regard markets as inherently problem-solving. The above discussion of process and product standards suggests that we should be observing different kinds of effects across different regulatory standards and regimes.