

# The Puzzle of Regulatory Competition<sup>1</sup>

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## ABSTRACT

Our understanding of international competition in regulatory policies has not progressed much because conventional theories lead to a bewildering range of conclusions. Empirical evidence has shown the limitations of simplistic models. Fresh work should overcome the obsession with ‘races’ and ‘final outcomes’ of conventional theoretical approaches and start modelling real-world mechanisms of regulatory competition. The first part of the article shows the limitations of conventional theories. The second introduces eight problems that explanations of international regulatory competition should address. It also discusses how the articles presented here contribute to the solution to problematic aspects of the puzzle. The conclusion reports results achieved in terms of key concepts of regulatory competition, sequences of cooperation and competition, the role of non-unitary actors in networked regulatory action, and why regulatory competition is still limited, both in the EU and in transatlantic relations.

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*‘A social science that explains why those with guns and the money win most of the time is hardly an accomplishment’*  
(Braithwaite and Drahos 2000: 579)

It is easy to explain why both the academic discussion and the political debate on so many different issues such as trade, environmental policy, labour policy, and taxation revolve around the notion of international regulatory competition. Simply put, regulatory competition may be, in different guises, a ‘problem’ for different actors – governments, pressure groups, individual firms, and advocacy non-governmental organizations.

It is less easy to pin down precisely why and how international regulatory competition is a problem or ‘has gone too far’ (Rodrik 1997). As often happens, one does not find a single source, but different – sometimes even contradictory – grounds for concern. Theories disagree about what to expect from the interaction between governments and markets in regulatory policy. Depending on the models used by different authors, theoretical work in this area predicts efficiency, inefficient races towards the bottom, or races to the top. Empirical evidence has shown the limitations of simplistic theorizations

in this area. But there is considerable disagreement on what empirical evidence really tells us. As will be shown in a moment, there is not much regulatory competition going on – hence all speculations about the final direction of the race do not stand up to a test of their basic mechanisms. Lacking an agreement on the direction of competition and how conclusive evidence is, our knowledge has not progressed much to date.

*Efficient equilibria and races: theoretical approaches and their limitations*

Work based on the classic model presented by Tiebout argues that international regulatory competition produces an efficient equilibrium. This is a simple extension to international regulatory policy of the well-known argument that competition among jurisdictions in federal systems is efficient (Tiebout 1956; Wilson 1996). But the efficiency properties of international regulatory competition depend on the absence of both market and political failures. The preconditions for efficiency, summarised by Barnard (2000a, 2000b) are rare, even in integrated markets. It is hard to find regulatory domains with full factor mobility, adequate and symmetrical knowledge of the characteristics of different jurisdictions, the possibility of preventing other jurisdictions from duplicating successful competitive innovations in regulatory policy, a wide choice of destination jurisdictions, economies of scale, and ‘jurisdictional latitude’ in the selection of regulatory laws (i.e., jurisdictions cannot be limited in the production of their laws by external constraints). As shown by Williamson (1985), frictions and transaction costs are a normal feature of markets.

More recent theorizations are less interested in the efficiency properties of the equilibrium and more interested in the direction of regulatory races. Typically, they add a more realistic model of politics, including a specification of the preferences of governments and firms. The most common alternative to Tiebout is the so-called race-to-the-bottom. Broadly speaking, a race-to-the-bottom arises under conditions of economic interdependence when a country unilaterally lowers regulatory standards in order to attract mobile factors of production, typically capital and highly skilled labour. The other countries will lose business, revenue, and human capital. They will therefore react by lowering their own standards. Jurisdictional competition creates a cycle of regulatory moves that ends up with all countries in a position that is worse than the one they could have secured by coordinating their policies. The cycle is well explained by the prisoner’s dilemma game. Rational independent governments will choose a dominant strategy Nash equilibrium that does not achieve the higher payoffs associated with international regulatory coordination.

The race-to-the-bottom emerges in sharp contrast with the efficiency properties of Tiebout’s model. Indeed, its policy prescriptions point towards

international coordination of regulatory policies. In policy debates, the race-to-the-bottom argument is not simply about the need to coordinate standards, but to coordinate at ‘appropriate’ or ‘correct’ levels (Klevoric 1996). This has often been a thorny issue in the politics of international coordination. Think of the debate on European Union tax coordination, with the European Commission and some member states proposing some ‘appropriate’ levels of minimum taxation of capital on several occasions, and other member states arguing that there is no empirical base for determining these levels. When arguments about races end up in proposals for coordination ‘at appropriate levels’, it is difficult to draw on ‘rational’ policy analysis for the identification of optimal minimum standards. Instead, we end up with regulatory domains characterised by contested political discourses.

The limitations of the race-to-the-bottom are well exposed by empirical tests. Empirical evidence informs us on whether governments engage in a race by lowering regulatory standards (environmental standards, incorporation laws, labour market regulation, corporate tax incentives, etc.) and whether mobile factors respond to these regulatory catches. The conclusions of empirical tests performed on the race-to-the-bottom point in two directions. Firstly, evidence from different policy areas does not corroborate the claim that regulations are a major factor affecting the choices of firms. Secondly, governments do not show high propensity to engage in prolonged races towards the bottom, even when there are favourable pre-conditions, such as mutual recognition in an integrated single market.

How does the empirical literature reach these two conclusions? It is fair to state up-front that there is still disagreement about the implications of these conclusions. As mentioned, one thing is to show the limitations of the race-to-the-bottom, another is to argue that regulatory competition is efficient. The programme undertaken by the Max Planck Institute in Cologne (Scharpf 2001) – to cite an outstanding example of those who insist on the inefficiency of regulatory competition – provides systematic empirical evidence on actual forms of competitive de-regulation, cases in which the policy-making capability of governments has been substantially reduced, and policies in which regulatory standards would have been higher if regulatory competition had not forced governments into sub-optimal choices (Genschel 2002).

This research programme has been eminently concerned with the EU, an area where both economic and legal integration have made considerable progress. As mentioned, one important trigger of regulatory competition in the EU single market is mutual recognition. Surprisingly, the impact of mutual recognition on (competing) regimes of national standards is still largely uncharted territory. In some sectors, such as telecommunications or

electricity, governments changed policy regimes with a view to phasing in competition rather than as a result of any competition amongst rules subsequently unleashed (Bulmer et al. 2003). Susanne Schmidt has examined the impact of mutual recognition in the insurance and road haulage sectors (Schmidt 2002). Her findings are that there has been relatively little use of regulatory competition in these policy areas. True, there has been considerable policy change in France and Germany (the countries she studied) but the evidence of competition amongst rules via mutual recognition has been, overall, minimal.

So we still do not know whether mutual recognition has spawned a race towards the bottom of domestic rules or not. Indeed, it is not entirely clear whether the main problem of the European markets is too much regulatory competition or the lack of it! Contrast the results of the Max Planck programme with the Competitiveness Reports released by the European Commission and with research funded by the business community on regulation in Europe (Galli and Pelkmans 2000). These reports argue that the European gap in productivity and performance with the US is due to the *lack of regulatory competition* within the EU. None of these documents complains about ‘excessive’ regulatory competition. Market liberalization, *smarter* regulation, and *greater* competition are instead considered the pre-conditions for a more dynamic EU (European Commission 2002).

Other studies have challenged the Max Planck programme’s argument that governments have suffered from an significant and deleterious erosion of their policy-making capabilities as a consequence of integrated markets – in the EU and elsewhere. Here there is consensus that integrated markets have modified the range of options that governments can realistically pursue. But this does not mean that the welfare state is withering away. Neither does it mean that the tax policy choices have been distorted (by regulatory competition) to the point of not being able to defend the welfare state (or, in another version, to the point of placing an unacceptable share of the tax burden on labour instead of taxing capital at ‘proper’ rates). Garrett (1998) and Swank (2002) have tested the impact of regulatory competition on domestic policy. Their findings are not supportive of a ‘bidding war where social welfare transfer, public services, and the tax burdens that support them are progressively lowered to a lowest common denominator’ (Swank 2001: 137).

Swank summarises his econometric analysis by arguing that ‘there is little evidence that capital mobility exerts systematic downward pressure on the public sector, the welfare state, and public service provision’ (Swank 2001: 154). In their analysis of the European ‘social model’, Ferrera et al. (2001: 187) find that globalization is ‘much less influential than many suppose’. The impact of Economic and Monetary Union is greater, but ‘far from

deleterious' – they argue – because EMU has encouraged creative solutions to employment problems in the Euro-zone.

Both Garrett and Swank stress the role of domestic institutions in the pace and direction of regulatory change – a finding supported by the analysis of Hallerberg and Basinger (1998) on tax reforms. In his book, Swank (2002) sets out to test two alternative explanations of globalization, that is, the 'diminished democracy theory' (this is the decreasing capability of domestic governments to pursue social policy goals because of globalization) and his own institutional approach, based on the idea that 'national institutions play a large role in determining ways in which national policy makers respond to the economic and political pressures associated with globalization' (Swank 2002: 274). He finds that evidence is 'disproportionately' in favour of the latter.

Taken together, these studies shed light on a critical aspect. As mentioned above, one of the assumptions of conventional explanations (Tiebout-type or races) is that governments will respond to globalization somewhat mechanically and engage in a regulatory race. But this assumes an institutional void. We need an institutional theory in order to explain how governments react to globalization. Globalization changes the opportunity structure within which domestic policy is made, but does not pre-determine the outcome. Indeed, once research designs have accounted for institutions, the conclusion is that market interdependence can enable as well as constrain governments (Weiss 2003).

Other studies question the other core assumption, that is, that capital responds to regulatory provisions for lower tax rates, lax environmental standards, varieties of 'social dumping', etc. Empirical studies on international tax competition induced by the liberalization of financial markets have detected quite a bit of 'capital immobility' (Gordon and Bovenberg 1996). This finding is consistent with Levinson's conclusion (1996: 450) that:

'Environmental regulations do not deter investment to any statistically or economically significant degree (. . .) The literature as a whole presents fairly compelling evidence across a broad range of industries, time periods, and econometric specifications, that regulations do not matter to site choice'.

One implication is that mechanistic approaches to regulatory competition have over-estimated the role played by regulation in market behaviour. Further, high standards may produce counterintuitive responses. Industrial location is sensitive to the local opposition to new plants, delays, a well-developed industrial base, labour costs, access to markets, and other non-regulatory variables. This reduces the propensity to change jurisdiction in response to 'high' environmental standards. Multinationals from more developed countries have a comparative advantage in complying with high standards (Pearson 1987). Accordingly, high standards in developing

countries encourage foreign investment from more developed countries. Finally, for multinational corporations operating in several jurisdictions it is more efficient to organise their operations according to the most stringent standards. There is indeed evidence that German and US corporations use the same environmental standards in developing countries as they do in their own home countries (Levinson 1996, Jaffe et al. 1995).

The mirror image of the race-to-the-bottom is the race towards the top. The argument for the race-to-the-top is associated to David Vogel's work (1995) on the so-called California effect (as opposed to the Delaware effect). In a sense, Vogel's model of regulatory cooperation generalises the empirical insights reviewed above by arguing that market integration can produce the opposite of the race-to-the-bottom, that is, competition for higher standards. Countries may respond to a first mover that raises standards by raising their own regulatory standards because they want to retain market access (see Genschel and Plümper 1997 for a formal treatment). His model has been influential for two reasons. Firstly, it explains why competition may produce a completely different outcome than the one predicted by the race to the bottom. Secondly, although market access and economic variables are crucial in his model, Vogel has entered political variables in the analysis of competition, by drawing attention to coalitions of domestic producers and public interest groups – the so-called 'Baptist-bootlegger' coalitions. Domestic producers that have to comply with high regulatory standards support the extension of these standards to producers abroad: they want to impose costs on their foreign competitors.

The debate on the empirical robustness of Vogel's prediction is alive. Braithwaite and Drahos (2000) have completed a comprehensive analysis of thirteen cases. Their list of regulatory regimes which have moved towards the top is quite long. It includes prudential regulation, regulation of intellectual property, accounting standards, anti-corruption regulation, and rules to crack down on money laundering. Beyond economic policy, the following social policy regulations have ratcheted up: labour standards (with some qualifications for professional services and elements of labour market de-regulation), health and safety regulations, and environmental standards. Competitive de-regulation has characterised air transport, capital movement, tariffs, technical barriers to trade, exchange rate controls, and telecommunications. Those are all areas where the overall welfare has increased as a result of focused de-regulation and re-regulation.

Even in the area of finance regulation, change has been shaped by domestic regulatory styles, conflict between different departments and agencies, and the degree of fragmentation of the sector (Loriaux 1997; Rosenbluth 1989; Reinicke 1995). A recent study of banking regulation in the UK and Germany confirms that domestic factors were more important than

regulatory competition and pressure coming from ‘Europeanization’ (Busch 2004).

On balance, empirical evidence seems more supportive of Vogel’s prediction than of the race-to-the-bottom. However, empirical studies have shown convincingly that *both markets and governments are far more inertial and stickier than simplistic models of races assume*. Vogel’s model (and its generalizations) are more accurate than Tiebout-type models and the race-to-the-bottom in terms of modelling the preferences of governments, firms, and NGOs. It provides a point of departure for future analysis. Its usefulness is all about shedding light on the politico-economic interactions at work, not about a general prediction of races towards the top. Indeed, there is nothing in Vogel’s work that should authorise us to think along these lines. His predictions are contingent on the presence or absence of certain conditions and mechanisms. Hence future work should concentrate on conditions and mechanisms. It should also look into the issue whether regulatory competition is really a race and if so what do we mean by that. Bold predictions about the final direction of the races and simplistic-mechanistic approaches may be a hindrance to our understanding of what goes on in real-world regulatory competition.

As mentioned, our project takes off from these claims. But the claims also raise a number of questions. Where do we need to look for further conceptual inspiration in order to understand the dynamics of international regulatory competition? How does ‘real-world’ international regulatory competition work? The next Section will seek to re-compose the puzzle by drawing attention to some fundamental elements. The argument presented here is simple. Instead of being obsessed with predictions, one should first understand who does what in the regulatory competition game and under what set of constraints and opportunities.

### *Eight uneasy pieces in the puzzle of international regulatory competition*

*Conventional explanations are based on simple mechanisms like arbitrage, but the conditions for arbitrage may be absent, and the mechanisms more complex*

Both Tiebout-type models and race-to-the-bottom models draw on regulatory arbitrage. The articles presented in this special issue remind us that the mechanisms at work are more complex. In any case, arbitrage can work only when there is already a good deal of transparency and information on different policy systems.

Taxpayers cannot choose easily by looking at the tax rate of country A in comparison to the tax rate of country B if these two tax systems possess marked differences in terms of tax administration, tax base, accounting methodologies, and enforcement. Under these conditions, the tax rates do

not provide enough information for arbitrage. Paradoxically – Besson notes (1999: 6) – tax competition should be higher under conditions of substantial harmonization! In a market, the price system often provides sufficient information for arbitrage. When one shifts from markets to public policies, the conditions for arbitrage become more problematic. In her account of how asylum seekers behave, *Barbou des Places* (this issue) shows that regulatory arbitrage is possible only when there is a balance of similarities and differences in national laws.

Another important point about arbitrage concerns the amount of information required to activate the option of exit from a jurisdiction. As mentioned, studies on capital mobility point to asymmetric information as one of the causes of limited capital mobility. Surprisingly, people may need much less information than capital to become mobile and exit from a jurisdiction. Asylum seekers do not calculate the costs of moving before they leave their country: simply – *Barbou des Places* reminds us – they are obliged to move.

A problem with conventional explanations (specifically the race-to-the-bottom) is that there is only one chain of events guiding competition. However, there are reasons to question this ‘one-size-fits-all’ approach to causal mechanisms. The causal story differs, depending on whether countries are competing in product or process standards (Holzinger and Knill in this issue). Ogus (1999) distinguishes between regulations that produce ‘mutually desired outcomes’ (e.g., property law and the law of contracts), and regulations that create winners and losers. He calls the former ‘facilitative law’ or ‘homogeneous legal product’ and the latter ‘interventionist’ or ‘heterogeneous legal product’. This resembles the game-theoretical distinction between coordination and cooperation games. According to Ogus, competition among systems of ‘facilitative law’ may not go as far as a race to the bottom: pressure groups (including lawyers) may gain from the status quo and hence act as veto players in the process of reform. In the case of ‘heterogeneous legal products’, the different national preferences in terms of level of protection act as powerful barriers to convergence towards lower levels of protection.

To conclude: the presence or absence of conditions for arbitrage makes a difference to our understanding of regulatory competition. However, the presence of these conditions is exactly what is not controlled for in most research designs. Arbitrage may require more regulatory transparency and cooperation than one would think. All the articles presented here do not assume the presence of low-cost arbitrage. Instead, they transform this assumption into a variable to be examined empirically. Even when the conditions for arbitrage are present, the causal paths are multiple – our project argues. By contrast, race models rely too much on ‘one (causal)-size-fits-all’ explanations.

*The concepts of 'top' and 'bottom' are elusive and normatively loaded*

The argument here is that fresh theorising should simply abandon the notions of 'top' and 'bottom'. The benefits of using these concepts do not justify the costs. The case of competition policy is instructive.

At first glance, there is no reason to expect races towards the bottom in this sector. A firm will not decide to locate in one particular jurisdiction because of its competition law. A host state's competition law is only one of the laws applicable in that country. The competition law of country A is generally concerned with all anti-competitive behaviour taking place within A. Hence all companies (domestic and foreign) harming competition in a given country will be targeted by competition policy.

There is another aspect of competition policy that is difficult to handle in standard versions of regulatory races. If competition law is exclusively concerned with the goal of efficiency, it will be a 'facilitative law' (following Ogus). It will not impose costs on firms, so there should be no competition among nations to attract business by 'degrading' regulation.

Is this the end of the story? Well, there are conditions under which one can expect some forms of regulatory competition. Competition law has different aims in different jurisdictions. Historical and legal research has demonstrated that US competition law is eminently concerned with efficiency. It does not necessarily provide a market with hundreds of price-taker firms and unlimited competition. By contrast, EU competition law would not allow large firms to unfairly exploit small firms. It is more concerned with pluralism in the market than with 'soulless, short-term aggregate efficiency' (this is how Fox 2000: 1791 illustrates the EU 'genetic code' of competition law). Now, market integration may bring the two notions to clash. If the US manages to Americanise competition policy worldwide, the EU may feel pressurised to abandon its own top and degrade its law.

Ideas about what is the 'top' are controversial: the US and the EU have different ideas about this issue. The same issue arises in media ownership regulation: for some political actors the 'top' is consumer's choice, for others it is pluralism and protection of different cultures (Harcourt 2003). In one school of thought in tax analysis, the 'top' is the taming of the Leviathan, that is, mitigating the tendency of rent-seeking politicians to increase tax levels. For another school, it is the preservation of domestic policy-making capability in terms of setting a level of taxation and a distribution of the tax burden that is fair and sufficient to produce a given amount of public goods (see the two schools in Frey and Eichenberger 1996). In asylum policy, the 'bottom' is not about relaxation of standards, but, perhaps, about setting stricter standards. But this is not universally accepted. The question is not about stricter or laxer standards, but about the quality of regulation. Indeed,

the real issue is degradation, loss of coherence, and overall quality of complex regulatory and legal systems (Barbou des Places, this issue). Hence, top and bottom are controversial constructs, normatively loaded. A large part of the political contest is all about defining what they are in a given policy sector.

All the articles presented in this special issue have a very sceptical and cautious approach to the notions of ‘top’ and ‘down’. Additionally, they try to account for complex mechanisms of interaction that cannot be captured by simple models of races. One source of complexity is that governments can play the regulatory game in two directions. They seek to influence international standards and they can resist pressure to conform to international policy regimes. In his account of British competition policy, Zahariadis starts precisely from the acknowledgement that EU member states can both seek to influence the formation of European competition policy regimes (particularly if they are pace-setters like the UK) and cope with the pressures coming from ‘Europeanization’. One additional puzzle with ‘Europeanization’ as intervening variable is that it is extremely difficult to find out whether domestic change is the consequence of races triggered by international capital markets, trade, and ultimately ‘globalization’ or the result of pressure that EU institutions and policies put on member states. It is difficult because more often than not ‘global’ markets and ‘Europeanization’ go in the same direction.

Zahariadis gets around this problem by using a ‘bottom-up’ perspective. Instead of tracking down the effects of regulatory races and EU pressure on British competition policy, he starts from the competition policy system at the domestic level (actors, resources, rules, system of interaction, and policy problems) and examines when and how the EU acts as arena, resource, or pressure. He finds that pace-setters like the UK may well have a latent competitive advantage in the race to influence EU policy, but they may not use this advantage if the domestic conditions (in terms of administrative capability, political willingness to act, and policy discourse) are not right. The lack of congruence between a domestic system and the EU regime does not necessarily trigger change and convergence. The mechanism of convergence is not top-down (as the literature on ‘adaptational pressure’ arising out of Europeanization often claims, see Börzel and Risse 2003), but bottom-up, with domestic politics driving the process.

*Explanations should account for races sideways or policy transfer*

Most of the studies presented in this special issue (Holzinger and Knill, Princen and Zahariadis) expose the limitations of the ‘black or white’ models (that is, either bottom or top) of regulatory competition. Our project looks at a third possibility: ‘lesson-drawing policy transfer modelling’.

Governments can imitate, translate, transfer, draw lessons, and ‘model’ each other, especially in integrated areas such as the EU (Bulmer et al. 2003; Radaelli 2000; Rose 1993). Transatlantic relations, for example, are a domain where power is eminently about who exports models and lessons and with what results – a point well illustrated by Princen.

Competition is all about being ‘different’: a company becomes more competitive than another by doing things that the competitors cannot do. The idea of imitation as a component – perhaps a key aspect – of regulatory competition may appear counterintuitive, but economists have always acknowledged it, since Schumpeter at least. Indeed, there is a surprising convergence on ‘modelling’ and ‘policy transfer’ in studies of regulation originated by different perspectives, such as organization theory, political science, law, and sociology.

Perhaps the most systematic treatment of races sideways in different regulatory domains has been provided by Braithwaite and Drahos (2000). They refer to these races as ‘modelling’. They set out to measure the power of modelling in comparison to the power of other (more traditional) mechanisms, namely military coercion, economic threat and reward, reciprocal adjustment, non-reciprocal coordination, and capacity building. Their empirical findings show that modelling has been the most important mechanism in global business regulation. This result is surprising for conventional views of international regulation. It may also have vast implications for the new research agenda on regulation, especially if one accepts the argument that modelling is:

‘a mechanism that may relate more to identity than to rational choice (. . .) Histories of globalization involve complex networked actions which means that few, if any, actors have the synoptic capacity to be rational in the way rational choice would have it’ (Braithwaite and Drahos 2000: 30).

Modelling includes both the act of showing something (like the fashion model parading with a new dress) and the process of copying and transfer. Thus, Braithwaite and Drahos (2000: 581) define modelling as ‘action(s) that constitute a process of displaying, symbolically interpreting and copying conceptions of action (and the process itself)’. Modelling therefore includes observational learning. It goes way beyond simple mimicry. As such, it is open to the insights of organizational theory on policy transfer as translation and interpretation (Czarniawska 1997).

Two results of this type of analysis stand out. Firstly, strategic modellers ‘routinely misunderstand and misrepresent what they are modelling’ (Braithwaite and Drahos 2000: 590). Hence, policy transfer is a very political process – the result is not necessarily convergence of countries around the same policy instruments and policy outcomes. Secondly, regulatory model diffusion ‘depends less on the power of the promoter than on the power of

the model'. This switches the research agenda from the classic 'big states versus big capital' approach to an agenda where reasoned argumentation and persuasion have a role to play. A promoter may have less power than well-endowed pressure groups. But this weakness may be compensated by the power of the model. This creates an advantage for policy experts, legal entrepreneurs, and other actors relying on expertise and reasoned persuasion.

*Conventional models do not turn analytic categories into variables*

The reference to actors and networks involved in races sideways brings our attention to actors. Too many stylized models stipulate unitary actors (the government, the business community) that, by definition, cannot vary. By contrast, Bernauer and Caduff endogenize important differences between interest groups and between firms. Whilst conventional international political economy is obsessed with the question 'who is in the driver's seat' of regulatory competition (capital or governments), Bernauer and Caduff look at the interaction between non-unitary actors. They bring public perceptions, the media, and ultimately the 'politics of problem definition' (Rochefort and Cobb 1994) back into the analytic framework.

Public perceptions and public outrage can influence the regulatory process both via market mechanisms (the image of a firm may suffer badly from public outrage followed by organized actions such as boycotts) and via politics (NGOs can exploit public scares by entering the political arena as 'legitimate' representatives of the public interest). There is also an interesting mechanism of interaction between public opinion and business behaviour – Bernauer and Caduff show. Public concerns about safety may have a 'pull' effect on producers willing to exploit the advantages of protectionist regulation. And the regulation may also have a 'push' effect on firms that do not benefit from stricter regulation, but nevertheless tolerate it as their brands are too vulnerable to public sentiments and may easily be targeted by NGOs.

Barbou des Places would probably agree with the quote at the beginning of this article and submit that regulatory competition is something more complex than a game between governments and capital. Public perceptions and (in her case) real people too play the regulatory game and drive regulation in different directions.

Where do the insights provided by this collection of articles lead us in terms of networks of actors and interaction? First, the question of who is in the driver's seat is often misleading. What really matters is interaction in complex regulatory networks. Second, most research has focused on what governments do: they attract capital, they respond to the pressure of international competition, and they cooperate. This, following standard

public choice terminology, is the supply side. But we do not know enough about how corporations and public opinion respond to international regulatory competition and, most importantly, with what effects on the final outcome of the race. The demand side of models is still relatively unexplored. The rigid mechanisms of games played by governments do not give much room to societal responses to international regulatory competition.

This leads us to the third point, that is, micro-behaviour and, more generally, the micro foundations of regulatory races. Some authors are seeking to model micro-behaviour by looking at sectors or firms. Heritier has worked on the interaction between regulator and regulated firms in railway policy. Hiscox (2001) has investigated coalitions in the politics of trade by looking at inter-industry factor mobility as a critical variable. But more work in this direction is needed.

Less systematic evidence on the demand side points to types of behaviour incompatible with conventional views of international regulatory competition. According to Porter (1990), firms that are early movers in meeting high regulatory standards have a comparative advantage. The best competitive strategy is to establish firm-level norms exceeding minimum standards and locate in jurisdictions leading the race-to-the-top. These firms will most likely press their governments in a direction which is different from the one hypothesized by the race-to-the-bottom. Braithwaite and Drahos (2000: 597–598) argue that the individual firm may resist regulation through industry associations, but ‘will refrain from resisting regulation itself’. This is because the individual firm has an incentive to free-ride on the resistance of others. To welcome regulators ‘with open arms’ at the factory’s gate is also a strategy to divert regulatory scrutiny away from the firm toward other competitors. This collective-action problem can make industry’s resistance to regulatory standards fragile, especially if ‘defecting’ firms (for example, early movers) meet the strategic support of non-governmental organizations (Braithwaite and Drahos 2000: 598).

Fourthly, actor-based models of international regulatory competition (no matter how sophisticated they may be in terms of micro-foundations) cannot afford to neglect institutions. A possible line of research is about blending the demand side of the models with institutional analysis. But the consequences of this re-orientation of the research agenda go well beyond the question of ‘demand’ and ‘supply’. The conventional models of competition in regulatory policy are based on the idea that companies will more or less react in the same way to ‘regulatory signals’. Capital, essentially, responds uniformly to various types of ‘price’ effects such as a decrease in the cost of incorporation, lower tax rates, lax labour standards, and reduction of environmental compliance costs. There should be no great difference between German capital and US capital, as far as their responses to the incentives provided by international competition are concerned.

The picture changes if one enters the institutional foundations of comparative advantage, following Hall and Soskice (2001). In their approach, competitiveness depends on four subsystems, that is, financial markets & corporate governance, education & training, industrial relations, and inter-company relations (especially in the area of technology transfer). An implication of this approach is that firms will *not* simply migrate where regulation is lax and labour cost is low, even if skills and labour productivity are high off-shore. Hall and Soskice reason that:

‘Firms also derive competitive advantage from the institutions in their home country that support specific types of inter- and intra-firm relationships. Many firms will be reluctant to give these up simply to reduce costs. Comparative institutional advantages tend to render companies less mobile than theories that do not acknowledge them imply’ (Hall and Soskice 2001: 56).

Further, international regulatory competition will trigger a different response in countries like the US and Germany. Nations gain from international trade and prosper in an era of regulatory competition ‘not by becoming more similar, but by building on their institutional advantage’ (Hall and Soskice 2001: 60). Hence, nations will become even more different.

*The ‘convergence or divergence’ dilemma requires more accurate approaches*

Do regulatory races lead to convergence or not? While this special issue is not focused on this topic (for reviews see Drezner 2001; Holzinger and Knill 2003), it nonetheless sheds light on relevant patterns. As mentioned above, Zahariadis presents a new bottom-up, ‘domestic politics’ model of convergence, in which convergence may be stimulated from above by the EU, but the decisive variables are domestic. Princen argues that traditional economic variables may well explain the likelihood of convergence and perhaps its direction, but political variables are decisive in terms of process and choice of policy instruments. By doing so, he opens the black box of the process of regulatory convergence and suggests directions for future research. He concludes that values and public perceptions are the key variables in explaining whether convergence is achieved or not in transatlantic relations.

Holzinger and Knill argue convincingly that convergence depends on the interaction between regulatory competition and cooperation. They suggest a rigorous approach in which one can predict convergence irrespective of the type of harmonization, type of policy and sequence of interaction between competition and cooperation. This result has significant policy implications, as the debate has revolved around different harmonization techniques to achieve convergence (see for example the discussion of regulatory rapprochement in OECD 1994). In their model, by contrast, convergence

does not depend on the use of minimum or total harmonization. If one relaxes the conditions set by Holzinger and Knill the results may change, but the advantage of their model is that it provides a rigorous, relatively simple ‘benchmark model’ from which one can depart.

Future research should look more closely to ‘what’ is converging. Economic models assume that one can work with simple constructs such as tax rates or the level of a standard. But in the real world systems compete by using systems of legal rules and complex policy systems. In legal scholarly work, the ‘convergence debate’ (briefly reviewed by Ogus 1999) argues that the similarity of legal rules may disguise considerable difference. Rules are embedded in legal cultures, administrations, enforcement structures and ultimately regulatory institutions that often differ markedly. Barbou des Places draws on the legal debate on convergence and shows when and how legal systems disciplining asylum seekers converge, and if so in what respect.

*Complex legal and policy systems exhibit low degrees of competition*

The last point about complex legal systems draws our attention to an important point. In ‘real-world regulatory competition’ capital and labour will not migrate because of a change in one standard. It is the whole policy system (rules, enforcement, institutional performance, and nexuses of comparative advantage) that matters. In the case of taxation let us assume that firms can engage in arbitrage. Even so, the taxpayer does not react to the price (the tax rate for example) in making her decisions. Instead of a price, the taxpayer faces two ‘baskets’ or ‘packages’: the basket of taxes and the basket of public goods provided by the state. In terms of the basket of taxes, taxation should be considered a plural term (following Besson 1999): there are different taxes (hence it is wrong to look at one tax independently from the others), fiscal bases, and fiscal rates. But there is no single tax price. Moreover, for each taxpayer, the fiscal basket has to be compared with the basket of public goods available in a jurisdiction (the point was made *inter alia* by Besson, 1999: 5). Indeed, most studies on tax competition at the sub-national level argue that companies locate in one jurisdiction instead of another by looking at a complex range of variables belonging to both the ‘fiscal’ and the ‘public goods’ baskets (Kenyon and Kincaid, 1991). Competition in corporate taxation cannot be examined only in relation to the tax system, but should take into account both baskets.

The implication is that an accurate analysis of tax competition should go beyond tax policy itself. The articles presented in this special issue (especially the study on asylum policy) seek to follow this suggestion in other policy domains. Inevitably, the degree of competition of whole legal or policy systems is much lower – and the effects in terms of races towards the bottom less pronounced – than in standard economic models. This explains why

empirical studies – reviewed above – have not found substantial evidence for the race to the bottom.

*Explanations of competition are flawed if they do not also account for cooperation*

One reason for the difficulties in the analysis of regulatory competition is that we do not have the right laboratory to conduct our experiments and tests. The world is not an arena where we can measure the impact of unfettered regulatory competition. There is already a good deal of regulatory cooperation at work (so much so that some authors talk of regulatory co-opetition, Esty and Gerardin 2001). This limits the value of predictions based on ‘pure’ models of competition: no government can act as freely as economic models assume. International policy regimes provide rules of cooperation that cannot be ignored.

Thus, we have to measure the effect of regulatory competition in the context of regulatory cooperation. The EU is an interesting case. The creation of the single market is an example of cooperation aiming at establishing the conditions for the competition among systems of rules. As mentioned above, competition requires a degree of cooperation before it can operate. Both Zahariadis and Holzinger-Knill take this point seriously and account explicitly for cooperation. Princen looks at competition in the context of rules of cooperation in trade. The main point raised by Holzinger and Knill is about sequences of competition and cooperation. The less interesting case is a sequence of cooperation via total harmonization followed by competition. Competition does not matter much if cooperation has already reached the aim of total harmonization. But all the other sequences illustrated by Holzinger and Knill are relevant for real-world policies. Their conclusion is that if cooperation follows an initial stage of competition, regulations will be driven up in the case of product standards, and down in the case of process standards.

*Regulatory competition is socially constructed*

As mentioned above, concepts such as ‘top’ and ‘bottom’ are politically contested and socially constructed. Add to this that ‘races’ do not operate in the simple way (up or down) predicted by economic models. Races sideways are often processes of editing and interpretation of policies in institutionally dense environments (Mörth 2003). This begs the question whether we need a radically different research agenda rooted in social constructivism. Although none of the articles presented here engages with this perspective, most of them leave the door open (or at least ajar) for this type of analysis. For example, Princen illustrates the role of values and public norms. This is

a fundamental aspect of social constructivist research. The question is what can be gained by opening the door and entering the world of ‘critical legal studies’ (Picciotto 2002), interpretative policy analysis (Fischer 2003), and ‘radical political economy’ (Amin and Palan 2001).

This may look like a very innovative research agenda, but actually it can draw on a long history of theoretical policy studies on the role of knowledge in the policy process (Radaelli 1995). The role of arguments and discourse in international regulatory policy is not easy to grasp, however. On the one hand, it reflects the increasing role of expertise, policy analysis, and science in regulatory choices characterized by uncertainty. Accordingly, recent research has targeted the political influence of regulatory epistemic communities, the changes triggered by legal entrepreneurs at critical junctures, and the emergence of cosmopolitan discourses among representatives of governments, the business community and non-governmental organizations. On the other, arguments can also be rhetorical and symbolic. They can also be used to arouse emotion and passion, often in conjunction with public scares or demonstrations. Thus, instead of a convergence towards reasoned ‘rational policy analysis’ based on scientific evidence, one can also expect more controversial discourses.

Lawyers interested in ‘regulatory law in action’ have indeed introduced the concept of ‘regulatory conversations’ (Black 2002) and investigated regulatory policy through the lenses of discourse analysis. This is a sea change from the idea of regulation as ‘top-down’ instrument of command and control. Discourse enters social interaction into the very fabric of regulatory policy. In his work on the regulation of genetic engineering, Gottweis (1998) examines how discursive practices fix meanings and demarcate the boundaries of ‘political’ and ‘non-political’ (the domain of genetic science, in his case). Policy narratives and other forms of discourse format the regulatory space and instantiate (often asymmetric) relations of power (Radaelli 1999).

An interactive and social concept of regulation can also accommodate emotions. In her recent essay on the emotional dimension in legal regulation, Lange (2002) argues that the meaning and policy substance of regulation is often shaped in day-to-day interactions between regulators and those who are regulated. Instead of separating the demand and supply side of regulation, she looks at the emergence of ‘small-scale, social orders’ (Lange 2002: 207). Drawing on Garfinkel’s ethno-methodology, Lange argues that reality construction is also an emotional process. Regulation, indeed, generates emotions (such as fear, anger, shame, but also positive emotions). In turn, this has consequences for the stability or instability of regulatory regimes. This is an element that appears neatly in Bernauer and Caduff’s paper, and surfaces in the model proposed by Princen. Lange would add that emotions (such as anger, calm, etc.) certainly enable agency. But the micro

level of day-to-day interactions also feeds into the development of social structures (Lange 2002: 219). Thus, a focus on emotions – Lange concludes – can assist the integration of agency and structure, bridging the gap between these two concepts. This is an advantage for the research agenda on regulation, often too biased either in the direction of actors or toward structures.

Some authors go as far as to foresee a ‘cultural political economy’ (Jessop and Sum (2001) or even a ‘libidinal political economy’ (Amin and Palan 2001: 566, drawing on Foucault) rooted in desires, fears, love, anxieties, and despairs. The orientation towards a social theory of regulation is clear, but this research agenda may also veer towards literary criticism (regulation as ‘text’ in active relationship with the ‘interpreter’), psychoanalysis, and anthropology.

The emphasis on social interaction lends itself quite naturally to an agenda based both on principles and regulatory webs. Regulation is shaped more by webs of dialogue than by webs of coercion (Braithwaite and Drahos 2000: 557). Webs of dialogue ‘frame’ regulatory problems, create commitments, institutionalize compliance, ‘lock-in’ cooperative behaviour, and distribute informal praise and shame. Webs of dialogue include dialectic logics, the contest of principles, and perhaps, following Lange (2002), emotions. One can take a structural approach on webs and talk of the structural power of knowledge, discourse, and narratives shaping webs. But one can also look at the actors operating within webs – hence bringing agency back in the analysis of regulation. It would be wrong to assume that networks and webs do not contain asymmetric power, however. Quite the opposite, they can produce and institutionalize asymmetric and contested relations, and one strand in the new research agenda looks at the legitimacy and democratization of international regulatory networks (Picciotto 2000, 2001).

In conclusion, there is some potential in going in the direction of social constructivism, interpretative policy analysis, and socio-legal studies. The potential, however, is limited by the fact that this strand of research has not developed a solid empirical base. So far the emphasis has been on theory (especially the assumptions in terms of logic of action), and normative analysis. Empirical research is still in its early days (see however Gottweis 1998 and Picciotto 1992 for outstanding examples). Another limitation is that the insistence on regulatory law in action and on social interaction lends itself to microanalysis of regulation. Now, we all know that, at the micro level, the social interaction between firms, citizens, and regulators matters, but how do we go back from microanalysis to the macro-politics of regulatory competition? The third limitation is that this agenda is not particularly concerned with regulatory competition. It contributes to our knowledge of the micro-foundations, helps us to introduce public sentiments and norms in our analytic framework, but does it really *explain* regulatory competition? The

jury is still out on this crucial question, although the most radical social constructivists would argue that explanation is just yet another contested discourse.

*Concluding remarks*

What does our project say about international regulatory competition? In the light of the articles presented in this special issue, where do the arguments about the effects of regulatory competition now stand? What should the EU and other institutions dedicated to international cooperation in regulatory policy do?

The eight uneasy pieces of the puzzle suggest a new agenda. The articles presented here contain suggestions and inputs for the new agenda, but no claim is advanced here that they recompose the puzzle. Instead, the claim is that our project sheds light on the dynamics and mechanisms of international regulatory competition. In terms of dynamics, we go beyond the simplistic discussion of races towards the bottom or the top. For one reason, it is not at all clear what the top and the bottom are in international regulation. ‘Top’ and ‘bottom’ are controversial constructs. They are often normatively loaded and make sense only within specific discourses, beliefs, and value systems. For another, our project has not found widespread race-like regulatory competition. Most importantly, the message is that fresh theoretical and empirical work should abandon the elusive notions of ‘races’, ‘top’, and ‘bottom’, drop the emphasis on ‘final directions’, and pay more attention to the actors and processes of competition. This is a new direction: conventional models are still informed by ‘black-box’ approaches where economic incentives for competition turn into races without explaining what happens in the box, who acts and how.

Add to this that all articles present solid empirical evidence that competition does not work by dint of simple changes in standards. It is the whole institutional-legal system of a jurisdiction that ‘competes’ with other systems. The result is that the overall degree of competition measured by the contributors to this special issue is modest, and so is the level of convergence. Moreover, our project takes issue with the conventional view of convergence as a process stimulated from above. Even in the EU, where Europeanization exerts pressure on domestic regulatory systems, domestic political variables have more explanatory leverage than top-down pressure.

This is where mechanisms enter the scene, in three fundamental ways. Firstly, instead of simple mechanisms based on unitary actors reacting to economic stimuli, this project has focused on networked action, where important differences between institutions, interest groups, and firms shape regulatory webs. Our contributors also show the importance of the ‘demand side’ of regulatory policy models – an innovation in a field dominated by the

analysis of the ‘supply side’. More importantly still, the obsessive question ‘who is in the driver’s seat’ does not account for the dense system of interaction between supply and demand actors.

Secondly, the mechanisms of regulatory competition, both in the EU and in transatlantic relations, depend on the social construction of policy problems, public perceptions, and regulatory discourses. One advantage of our project is that it shows how to generate solid empirical analysis on concepts that have been often over-theorized and under-investigated empirically. Thirdly, the mechanisms of regulatory competition should be examined jointly with mechanisms of cooperation. Not only is some non-trivial degree of regulatory cooperation a pre-condition of competition, but, as shown by Holzinger and Knill, the two elements interact in precise ways within sequences. The work on sequences of competition and coordination presented here both in the abstract model of Holzinger-Knill and in the dense narrative accounts of the other contributors, provides new insights into their effects. (Esty and Gerardin 2001).

The final question of what international institutions should or should not do goes beyond the scope of this project. But one result of this project is that some demands on the EU and other institutions to curb regulatory competition are misplaced, as their main task is still to provide ‘cooperation for competition’, that is a regulatory level-field where social, economic, and political actors can respond to transparent signals.

#### NOTES

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