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# New Insights from the Old Continent

## By Michael S. Greve

*Federalism poses the challenge of reconciling political decentralization with the demands of an interconnected, fast-paced economy. In going about that task, America should learn an important lesson from the Europeans.*

*This is not a joke. In many regulatory areas the European Union applies a principle of "mutual recognition" among member states that renders political borders and decentralization consistent with economic efficiency and market integration and is, moreover, conducive to those objectives. This* Federalist Outlook *describes the Europeans' striking discovery of a core principle of a liberal federal order. It also explains why the European policy elites are bent on repudiating that principle and why they will succeed in doing so. The United States should take the opposite course: we should adopt mutual recognition among states as a central principle of federalism and regulatory policy.*

### From Common Market to Constitution

The beast in Brussels is not *federalism* in our sense of the word. The European Union is still a bunch of states united, not a United States of Europe. It is a government over governments, not citizens. Economic and regulatory issues continue to dominate the operations of the Brussels bureaucracy.

The politicians' chatter, however, has moved well beyond a common economic market and toward a full-blown European state, and politics will soon follow suit. Leading officials from German foreign minister Joschka Fischer to French prime minister Lionel Jospin have urged the creation of a European federalism with ruffles and feathers.[1] Meeting in December 2001 in the Brussels suburb of Laeken, the European heads of state celebrated their new common currency and established a convention to draft, by the year 2004, a constitution for a larger and more integrated Europe. The convention will be chaired by Valéry Giscard d'Estaing, whose native France has since 1789 amassed a great deal of experience with constitution writing.

Political integration is commonly viewed as a next step on a path toward closer cooperation and integration into a common European market. That view, however, is decidedly not the vision that animates the proponents of a European constitution. Rather, their project explicitly rejects a "mere" common market, which embodies libertarian or, as the Europeans sneer, "neoliberal" values of competition, choice, and mobility. The purpose of the constitutional project is to replace those values with more European, political aspirations.

The success of that project is a foregone conclusion. Now is the time, therefore, to obtain from the Europeans illumination on the use and usefulness of the neoliberal principle par excellence—the principle of reciprocity and "mutual recognition." Broadly applied within the European Union but, sadly and ironically, little known in the United States, that principle allows

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decentralized political institutions to coexist with a common, open, and efficient economic market. The Europeans will bury mutual recognition. America should do the opposite.

## Mutual Recognition

The European Union recognizes political decentralization as a constitutive principle. The 1992 Maastricht Treaty contains an official commitment to subsidiarity, meaning that decisions should be made by the lowest "appropriate" level of government. But the European Union is also committed to a common market, unimpeded by state protectionism and economic warfare. For two decades, the European Union has worked toward ensuring the "four freedoms" (the free flow of capital, labor, goods, and services), with a fair measure of success.

In competing for mobile capital, labor, goods, and services, member states will tend to favor and protect their own industries and constituents against "foreigners." Those tendencies come, so to speak, with the territory, but they obviously violate the common-market principle. The European treaties prohibit flagrantly protectionist measures, such as tariff barriers. Explicit bans, however, are only a partial solution, since member states have countless ways to disguise protectionist barriers—for example, as "consumer protection."

One way of dealing with the problem is to mow down local differences and obstacles to trade by means of central political intervention. We call that process "federal preemption"; the Europeans call it "harmonization." The difficulty, though, is obvious: if the central government were to harmonize all the differences that stand as barriers to trade, nothing would be left of decentralization, federalism, and subsidiarity. Moreover, central harmonization will often be perceived as meddlesome and illegitimate. Sausage standards and other such regulations have exposed the Brussels bureaucracy to widespread ridicule and criticism.

Unless cross-border trade is harmonized, it must be governed either by the rules of the country where a particular good or service ends up or by the rules of its origin country. The former "destination" principle would compel each company to comply with different and often conflicting regulations in all the member states where its products might end up. The result is not a common market but a collection of regulatory fiefdoms. The solution to this dilemma is the opposite, origin-based rule: so long as a company in a member state complies with the laws of its home state, it may freely sell its goods and services in other member states.

The European Union has officially recognized the origin principle. It is commonly called the principle of "mutual recognition." It is more than a simple jurisdictional rule. Rather, it is the *only* principle that is consistent with both a common economic market and political decentralization.[2] Mutual recognition integrates member states without central intervention. For an actual example, France may prohibit the production of Edam cheese with less than 40 percent fat content; Holland may permit it. Under a principle of mutual recognition, the Dutch version may be sold in France. Dutch cheese producers need not conform to the standards of France (and Germany and Britain and Denmark); they need only comply with their home country's rules. The European Commission need not do anything to harmonize French and Dutch cheese regulations. Each country gets to keep its own laws. The legal differences are harmonized in the private, common market—by consumers, who decide whether they want this cheese or that.

Mutual recognition, then, liberates commerce by eliminating the cost of complying with different, conflicting, and often incomprehensible rules. Beyond that, mutual recognition institutionalizes jurisdictional competition. Consumers will pick products that come with a country standard that suits them. Firms will in turn locate themselves in a country with rules that their customers, shareholders, and workers prefer. The ability of individuals and firms to vote with their feet, modems, and pocketbooks will liberate markets and discipline politicians.

## The Benefits of Mutual Recognition

Cassis is the black currant elixir that turns white wine into kir. The German authorities once prohibited cassis imports: containing about 20 percent alcohol, the stuff was too boozy to qualify as wine and not boozy enough to constitute serious liquor. Notwithstanding the German authorities' various justifications (including a "public health" theory, hilarious in a country where preteens can buy beer, positing that not-so-hard liquor might introduce young consumers to the real stuff), the European Court of Justice ruled that the German regulations constituted a protectionist violation of the European treaties. If cassis can be sold in France, the court ruled, it can be sold in other EU countries.[3]

That pathbreaking 1979 decision in the *Cassis de Dijon* case established mutual recognition as a binding principle. Mutual recognition has since been confirmed in many decisions of the European Court of Justice. Following the publication of an important white paper on the internal market in 1985, mutual recognition was also adopted as a regulatory principle, meaning that the European Commission can adopt mutual recognition as an alternative to central harmonization, either by directive or by dragging recalcitrant member countries before the court.

The principle is applied most extensively in the trade of goods. Thanks to its assertion by the European Court of Justice, one may now import pasta into Italy, Edam (as noted) into France, and cassis and even beer into Germany, whose ostensibly health-oriented beer purity laws had previously shielded domestic producers from foreign competition. In January 2002 neighboring Denmark—confronted with a mutual-recognition complaint it was sure to lose—agreed to abolish a law requiring beer to be sold in bottles. Now that brewskies may also be sold in cans (the only economical way of shipping beer into the country), Tuborg and Carlsberg (the two Danish producers) will have to compete with outsiders.

Mutual recognition also applies, though, to issues such as companies' choice of corporate charters. In its intensely debated 1999 *Centros* decision, the European Court of Justice effectively adopted, for the European Union, the American, state-based system of corporate chartering. That system allows a firm to incorporate in any state and to have its charter—and the legal rights and obligations that travel with it—recognized in all other states.[4]

Corporate chartering provides a powerful illustration that mutual recognition does not simply eliminate the costs attendant to the legal conflicts and duplication that arise under destination-based regulation. Mutual recognition also harnesses competition among states (or countries) for the benefit of citizens. If a firm chooses state laws that, for example, allow the management to reduce shareholder control, well-informed, "marginal" shareholders will demand and obtain a premium, and the stock price will drop.[5] Hence, corporations will tend to choose state charter laws that maximize shareholder value.

Mutual recognition does not unfailingly solve every regulatory coordination problem. Spillover effects from one member state into another, for example, may require central political coordination.[6] Even in the area of corporate chartering, mutual recognition may not be a perfect long-term solution for the European Union. Corporate law regimes vary greatly among the member countries, and they are deeply entangled with very basic institutional and legal arrangements, such as Germany's codetermination laws and banking structure. Such rigidities may prevent corporations from sorting themselves into legal regimes that would enhance shareholder returns.[7]

Even so, mutual recognition provides an optimal solution to many regulatory problems—or, more moderately and precisely, a better solution than central harmonization. Three considerations, moreover, have rendered the principle particularly suitable for the European Union. Two of them have to do with the difficulty of engineering the integration of countries whose legal, political, and economic institutions differ greatly. The third factor is the dramatic technological and economic change that has accompanied the creation of the European Union.

**Transition.** Mutual recognition is particularly suited to an emergent supranational organization that faces the challenge of breaking up older, entrenched regulatory regimes at the subordinate levels.[8] Central harmonization will proceed too slowly and, moreover, will likely produce compromises among parochial interests rather than a genuinely free market. The European Union, of course, is still working through its economic integration program. Because of the difficulty of procuring the requisite supermajorities among a growing number of EU members, the harmonization of financial services, telecommunications, and countless other matters have proceeded at a snaillike pace. Mutual recognition provides an attractive alternative.

**Heterogeneity.** European countries differ from one another much more than American states do. Heterogeneous preferences (across state lines or among individual consumers) are a powerful argument for competition instead of harmonization. For example, few consumers will prefer a sickening sausage to a safe one. No harm is done by a harmonizing rule that suppresses a consumer "preference" for a spoiled product—if indeed that preference exists. In contrast, consumer tastes for, say, financial privacy vary widely. Harmonization will suppress many legitimate preferences, including some that are far from the political equilibrium point. Mutual recognition allows British and German privacy laws to coexist. Consumers will enjoy a choice among the many financial products offered and the laws that travel with them.

**Ignorance and Change.** Harmonization may be a sensible solution when the world is relatively static; when we

know what we are doing; and when uniformity yields decent returns. A sickening sausage will not become harmless tomorrow; we have a century of experience with health regulation; and consumers will benefit from a standard for a product whose characteristics they cannot easily discern.[9] But when the world changes rapidly and we do not know what we are doing, mutual recognition is generally preferable. By the time the European Union (or for that matter the U.S. Congress) gets around to examining consumer privacy on the Internet, the technology on the ground will have changed. Moreover, nobody knows what privacy norm might best accommodate consumer preferences at a reasonable cost. Mutual recognition leaves that decision to the member states' individual and, no doubt, varying decisions. Individual governments—and consumers—will make mistakes. But they will not make the same mistake all at once, and we will learn from their mistakes more readily than we would under a centralized regime.[10]

## Advantage Europe

Mutual recognition institutionalizes, in politics, the values we associate with markets—competition, choice, diversity, local control, learning, and innovation. European integration through mutual recognition proceeds without central control and regimentation. It is a form of integration that Lady Thatcher could support and did in fact support.

It is thus curious that the Europeans should be far ahead of the United States in viewing mutual recognition as an efficient means of harmonizing, as it were, the demands of economic integration and political diversity. Here at home, mutual recognition governs corporate chartering—but almost nothing else. Tort law, insurance and financial regulation, state taxation, product labeling, and most other areas of regulation are either subject to a destination rule or else preempted under federal law. No American legislator or corporate executive has ever heard of mutual recognition, let alone pressed it as a serious policy option.

Even in Europe, the principle is shot through with exemptions. The most important of them is a broad exception for national laws that are deemed essential to legitimate national purposes, including credible health concerns. That exception often turns applications of the elegant mutual recognition principle into unappetizing brawls over whether a particular country's regulation is truly public-interested or rather an exercise of protectionism in disguise. The central political authorities tend to respond by establishing "minimum" standards. Even so, the principle is recognized, applied, and widely discussed as a policy prescription for a broad range of regulatory issues. European law journals, white papers, and EC proceedings contain instructive discussions of the relative merits of competition and mutual recognition versus harmonization, and CEOs and bureaucrats sustain a nuanced discussion on the subject.

Are we to infer, then, that the European elites are libertarians at heart? We are not. Rather, the European Union owes the discovery of mutual recognition, first, to a healthy institutional rivalry between the European Court of Justice and the European Union's other central organs. The development and implementation of mutual recognition have principally been the work of the European Court of Justice. Unlike the European Commission, the court is not directly susceptible to centralizing political pressures (about which more below). To the extent, moreover, that integration proceeds under the *Cassis de Dijon* principle rather than under bureaucratic harmonization, the court rather than the commission emerges as the driving institution. The court has a big institutional stake in its doctrinal handiwork.

Mutual recognition is, second, a product of the European Union's origin as an economic rather than a political conglomerate. So long as economic objectives remain foremost in mind, mutual recognition will appear as a viable means of integration—if only because the difficulty of procuring consensus within the central regulatory institutions renders it the *only* available option. The principle does constrain the member states' sovereignty, but Brussels often welcomes means—even otherwise distasteful free-market means—of weakening national governments. The costs will in any event seem bearable so long as economic integration is viewed as a step that must be completed before the European Union can move on to grander political plans.

Those plans, though, have now taken center stage. The European political class is bent on establishing pan-European, sovereign political institutions. (Even the introduction of the Euro is at bottom not an economic undertaking but rather an effort to endow the European Union with an incident of sovereignty.) As political aspirations begin to dominate the process of European integration, mutual recognition will be jettisoned. The campaign for a European constitution is an explicit attack on a neoliberal Europe.

## Consumers and Citizens

In a much noted June 2001 speech on the need for a European constitution, the eminent German philosopher and sociologist Juergen Habermas has taken aim at the project of a European Union as a mere common market. That construct, he avers, implies a notion of individuals as "rationally deciding entrepreneurs who exploit their own labor." Its ideal is a "postegalitarian society that tolerates marginalization" and the "exclusion" of the less fortunate. An economic union reduces citizens to "members of a market society" and the state to "a service institution for clients and customers." Such a union implies a politics that pretty much "takes care of itself," as distinct from an energetic, participatory enterprise. In short, Habermas argues, an economic union demands far too much of individuals and too little of politics.[11]

Professor Habermas is a reliable bellwether of the European Left. His sentiments parallel those of Monsieur Jospin and Herr Fischer, whom he rightly credits with having shaped the agenda for a European constitution. And while Habermas does not explicitly discuss "mutual recognition" as a regulatory strategy (he knows nothing about regulation, except that he favors it), that principle provides a pristine example of the presumptions against which he inveighs.

National consumer protection laws are based on the idea that Otto Normalverbraucher (Joe Sixpack's Teutonic cousin) is an idiot. That belief is held rather more firmly in Europe than in America. "Money-back" guarantees, for example, are in many European countries treated as a menace to consumer protection. (The authorities' theory that such guarantees will induce consumers to pay higher prices has landed Land's End and other American companies in great trouble over there.) Mutual recognition enables sophisticated consumers to avail themselves of the benefits of lenient jurisdictions (inside the European Union, though not necessarily America's cowboy economy)—at the price, however, of exposing dumber consumers to exploitation. By enabling and, in a way, compelling consumers to shop around for suitable price-plus-protection packages, mutual recognition effectively repeals the premise on which the domestic laws rest. As continental lawyers put it, mutual recognition is not really "public law" at all; it is a kind of contract law through the backdoor.

Mutual recognition demands too little of politics because it reduces the central authority to a role of maintaining the rules of the competitive, integrative game and the national governments to providers of "law as a product" that matches the preferences of consumers and producers.[12] True politics, however, means the active construction of public norms, values, and institutions, and that aspiration is thwarted when countries must act, as mutual recognition compels them to do, under competitive pressures. For example, one cannot construct a welfare state on principles of solidarity and equality if the characters who are supposed to pay for those things are permitted to migrate to less communitarian and egalitarian (and exploitative) jurisdictions.

Habermas denounces the premises on which mutual recognition rests as the "building blocks of a neoliberal world view," and he declares them at odds with "the Europeans' normative self-understanding." The European Union must therefore construct a European society of citizens, a pan-European "public sphere," and a shared European political culture—not as a complementary step after economic liberalization, but precisely to confine economic competition and choice to a subordinate sphere. That, in a nutshell, is the point of a European constitution.

## Interests and Bureaucrats

Habermas and his acolytes are correct in noting the tension between the claims of citizenship and consumer welfare, between politics and economics. Mutual recognition reconciles those conflicting claims but, in so doing, limits politics. For instance, it deprives the citizens of one country, collectively, to lock their fellow citizens into an elaborate welfare state. The argument that a thoroughgoing application of mutual recognition would unduly constrain sovereign countries is not altogether implausible.

The Europeanists, however, resolve the tension entirely in favor of politics. They contrast a caricature of markets as a sphere of pervasive exploitation with an idealized vision of politics, where free and equal citizens communicate and "discourse" in a "common public sphere." Elaborate welfare-state provisions have nothing to do with redistribution; rather, they form the real basis of citizens' "autonomy." In Juergen Habermas's political world, no interest group or empire-building bureaucrat ever enters an appearance.

This rarified view of politics is fantastic especially in the European context, where the political class has driven European integration forward without the consent, and quite frequently over the explicit dissent, of the voters in

the various countries. (Habermas et al. recognize the European Union's "democratic deficit," but their proposed solution is more alarming than the problem itself. We will get to it.) Moreover, the highfalutin assault on neoliberal principles is almost entirely superfluous. The interests and politicians that populate the real world may appreciate Juergen Habermas's composition of a suitable funeral march, but they will bury those principles with or without him.

Trade unions, environmental interests, and any other interest group whose agenda rests on redistribution consistently oppose mutual recognition: they cannot rob Peter to pay Paul if Peter is allowed to escape to more hospitable climes. Business interests, for their part, generally prefer centralization to mutual recognition and jurisdictional competition. Beneficiaries of protectionist legislation naturally resist exposure to competition. Even procompetitive industries, however, must guard against the possibility of harmonization that will hurt them, and the most effective way of fighting that threat is often to get to Brussels (or for that matter Washington) before their competitors do.[13]

Behind every seemingly senseless Brussels regulation stands an interest that demanded it (and, in demanding it, was backed by its home country). Britain, for instance, barred the sale of upholstery not treated with fire retardants, ostensibly on the grounds that untreated upholstery would threaten public safety in restaurants and discos. Continental EC members sued the country before the European Court of Justice—with little hope of prevailing. Although the British upholstery law was transparently protectionist and its public safety justification, obviously pretextual (a nonpretextual rule would regulate restaurants, not furniture makers), the regulation probably falls into the class of "essential" public safety laws that are thought to be exempt from the *Cassis de Dijon* rule. The case was dropped and the dispute wound up before the European Commission, where it generated a protracted harmonization proceeding and wrangling among governments and interest groups, including a fierce fight between the manufacturers of halogenated and nonhalogenated fire retardants. In a sense, the European Commission got to the bottom of the dispute.[14]

Central authorities are naturally receptive to interest group demands for harmonizing intervention. For now, the Brussels bureaucracy has settled on the formula that mutual recognition is probably fine—provided that the jurisdictions conform to roughly similar, minimal standards. For reasons mentioned, the benefits of arbitraging differences in private rather than political markets are most substantial when those differences are large. The Brussels commitment to "minimum standards" is an attempt to harness mutual recognition for the purpose of reducing administrative and compliance costs. As noted, though, mutual recognition also promotes choice and competition among governments, and minimum standards tend to eliminate those benefits. That is so especially since the "minimum" environmental, health, and technological standards, on the way to the common political forum in Brussels, have a funny way of mutating into the standards of Germany, the most demanding jurisdiction. In suppressing competition from less advanced jurisdictions, the European Commission obeys the political logic of harmonization—and gets the economic logic of mutual recognition backwards.

## Come the Constitution

As the harmonization agenda expands, and as the European Union itself expands to include new—and much poorer—members, the practical and political problems of integration through harmonization increase exponentially. The European Union's central institutions are not directly elected and therefore lack legitimacy. Rotation and supermajority requirements render their operations cumbersome and time-consuming.

To the attentive reader, the elegant solution presents itself: unburden the political institutions, and let mutual recognition do more of the integration work. That, though, means added strain on the Western welfare and ecostates, as production would move eastward in search of lower labor and production costs. Accordingly, the Europeanists have consistently urged the opposite route of strengthening the democratic legitimacy and steering capacity of the central European institutions. A constitution for a federal Europe will supply those missing ingredients by providing for some form of direct elections and a parliament with taxing authority over citizens.

The Brussels bureaucracy is acutely aware of its reputation as an illegitimate meddler. At the margin, that awareness inhibits yet more meddling and acts as an incentive toward mutual recognition as the only available means of integration. A European constitution, providing for an elected European executive, will remove that constraint and incentive. Attacks on the "undemocratic" edicts from Brussels—standard fare especially among British Tories—are correct but short-sighted: a democratic Brussels will be infinitely worse.

As for steering capacity, the ability to collect revenues from citizens directly (rather than through requisitions from member countries) will enable the central institutions to procure harmonization through transfer payments. A rich country will desire—and can afford—expensive environmental and worker protections. A poor country has a lower preference for such goods and is less prone to expropriating producers to procure them. Since producers prefer such an environment, poor countries favor a mutual recognition regime that allows producers to act on their preference. Rich countries that desire economic integration will have to pay that price—unless, that is, they can buy the poor members' assent to harmonization. The European Union in its current form must rely on contributions from member states that are too small to permit intergovernmental transfers on a grand scale. Under a European constitution and a government with direct taxing authority, in contrast, that harmonization strategy will constitute the European parliament's principal activity.

Even in a postconstitution Europe, experts will debate mutual recognition in one or another regulatory arena. But that is wonk stuff, and the prorecognition wonks will lose all but a handful of skirmishes. The creation of a European constitution will be accompanied by solemnities about delineating federal responsibilities and about subsidiarity. All that, though, is cant: Brussels alone will determine the lowest "appropriate" level of government intervention. Mutual recognition, as a form of institutionalized competition and decentralization, is dead.

## The United States: No Habermas!

For altogether selfish reasons, Americans should lament the impending demise of mutual recognition. American consumers have sustained the world economy for quite some time. We deserve a break, and Europe could give us one. (Who else—Japan? Brazil?) Europe could unleash its considerable economic might by curbing overregulation and deflating its bloated welfare states. Mutual recognition might not attain that objective, but it would at least push in that direction. Instead, the Europeans will harmonize their way toward a common constitution and citizenship, with dental care for all and the death penalty for none.[15] Should the voters in some countries have the gall to object, the project for a democratic Europe will proceed without their consent.

America cannot change that outcome. What we can and should do is to infuse our own ailing federalism with a healthy dose of mutual recognition. The centralizing interest group dynamics that are suffocating neoliberalism in Europe have, over the past eighty or so years, exacted a heavy toll on American institutions, to the point where we, too, confront the dual challenge of breaking entrenched state regimes and fighting excessive centralization at the same time. But we also have a Constitution that was established in support of neoliberal values, not against them. We have a Supreme Court that appears at long last prepared to apply the Constitution accordingly and that might well adopt the logic of mutual recognition if its central role to a liberal federal order were explained to the justices. Perhaps most important, those values retain purchase among ordinary citizens, and even among intellectuals. Our political elites lack the ruthlessness of their European counterparts, and they have no Juergen Habermas to fuel and legitimate statist ambitions.[16]

Those advantages may not prove sufficient, but they do provide a cause for optimism. For practical suggestions on the extension of mutual recognition on American soil, consult an upcoming *Outlook.*

## Notes

1. Joschka Fischer, "From Confederacy to Federalism—Thoughts on the Finality of European Integration," speech delivered at Humboldt University, Berlin, May 12, 2000; available at the Jean Monnet Program Web site (www.jeanmonnetprogram.org/papers/00/symp.html). Mr. Fischer's speech has sparked an extensive political and academic debate, examples of which are available at the above Web address. Lionel Jospin's speech, "What Are Our Ambitions for the European Model of Society?" May 28, 2001, is available at www.info-france-usa.org/news/statmnts/jospin/jospeuro.asp.

2. For a powerful presentation of this argument, see Wolfgang Kerber, "Interjurisdictional Competition within the European Union," *Fordham International Law Journal,* vol. 23 (2000), p. 217.

3. *Rewe v. Bundesmonopolverwaltung fuer Branntwein,* Case 120/78, [1979] E.C.R. 649, [1979] 34 C.M.L.R. 494.

4. The European Court of Justice's *Centros* decision of March 1999, C-212/97 ECJ, is predominantly, though not uniformly, viewed as having imposed a U.S.–style incorporation regime on the European Union. See, for example, W. F. Ebke, "Das Centros-Urteil des EuGH und Seine Relevanz fuer das Deutsche

Internationale Gesellschaftsrecht," *Juristenzeitung,* vol. 54 (1999), p. 656.

5. See Roberta Romano, *The Genius of American Corporate Law* (AEI Press, 1993).

6. For example, a merger of two companies domiciled in country A may have profound anticompetitive effects in country B (but not A). In that case, it seems a bit much to demand B's unquestioning recognition of A's merger approval. This jurisdictional problem has been a recurrent source of transatlantic spats over merger approvals, as well as a subject of an intense intra-European debate as to whether a "competition among competition policies" (as antitrust law is known in Europe) is a viable option.

7. See, for example, Klaus Heine and Wolfgang Kerber, "European Laws, Regulatory Competition, and Path Dependence," paper prepared for the Twentieth Annual Meeting of the International Society for New Institutional Economics, 2000; and generally Lucian Bebchuk and Mark J. Roe, "A Theory of Path Dependence in Corporate Ownership and Governance," *Stanford Law Review,* vol. 52 (1999), p. 127.

8. Wolfgang Kerber, "Rechtseinheitlichkeit und Rechtsvielfalt aus Oekonomischer Sicht," in *Systembildung und Systemluecken in Kerngebieten der Harmonisierung: Europaeisches Schuldvertrags und Gesellschaftsrecht,* ed. S. Grundmann (1999), pp. 67, 96.

9. One may quarrel with this conventional argument for "lemon laws" on empirical grounds (for instance, by arguing that intermediaries up and down the distribution chain have adequate means and incentives to ensure product safety), and surely there is no reason for sausage standards to dictate the length of the product as well as its nutritional characteristics. But the basic argument is clear enough.

10. For applications of this venerable Hayekean argument to the modern European context, see, for example, Frank H. Easterbrook, "Federalism and European Business Law," *International Review of Law and Economics,* vol. 14 (1994), p. 125; Robert D. Cooter, "Structural Adjudication and the New Law Merchant: A Model of Decentralized Law," *International Review of Law and Economics,* vol. 14 (1994), p. 125; and Kerber, "Rechtseinheitlichkeit und Rechtsvielfalt."

11. Juergen Habermas, "Warum Braucht Europa eine Verfassung?" The speech was delivered at the University of Hamburg and subsequently printed in *Die Zeit,* a prestigious German weekly. It is available at www.zeit.de/2001/27/Politik/200127_verfassung.hmtl. The quotations in the text are my translations.

12. The allusion in the text is to a pathbreaking article on the virtues of jurisdictional competition: Roberta Romano, "Law as a Product: Some Pieces of the Incorporation Puzzle," *Journal of Law, Economics, and Organization,* vol. 1 (1985), pp. 225–83.

13. Business firms rank their options as follows: destination principle (absolutely intolerable); harmonization (acceptable, depending on the terms); mutual recognition (best, if it can be procured). Firms and lobbies, however, confront a massive collective action problem. Unanimous support for mutual recognition might well ensure that outcome. Unless, however, a binding rule affirmatively prohibits central harmonization, that outcome is a real possibility, and the central authority will be very adept at peeling off the first defector by promising favorable harmonization terms. Once that happens, defection from the antiharmonization position is the dominant strategy.

14. The proceeding ended inconclusively when Jacques Delors, citing subsidiarity concerns, personally yanked it from the commission's agenda. Mutual recognition apparently never entered the picture as a possible solution. For a blow-by-blow account of the episode, see J.-M. Sun and J. Pelkmans, "Regulatory Competition in the Single Market," *Journal of Common Market Studies,* vol. 33 (1995), pp. 443, 454–56.

15. I wish I had made this up, but I did not. Professor Habermas explicitly insists on generous welfare benefits as a precondition of full and autonomous citizenship and on a constitutional prohibition against the death penalty as a vital means of forging a European identity through a repudiation of a fascist past.

16. Juergen Habermas's most influential American disciple is the prolific Professor Cass Sunstein. See, for example, Sunstein, *Free Markets and Social Justice* (Oxford University Press, 1997). Professor Sunstein deserves credit for making the neo-Stalinist implications of the program for a "communicative" democracy more explicit than does Habermas himself. See, for example, Sunstein, *Republic.com* (Princeton University Press, 2001); and Sunstein, *Democracy and the Problem of Free Speech* (Free Press, 1993) (arguing for massive, government-engineered redistribution of speech rights). Cass Sunstein, however, is hardly a household name, and he teaches at, of all places, the University of Chicago Law School—the hottest of neoliberal hotbeds.