

Revised  
January 2003

**Assigning powers in the European Union  
in the light  
of yardstick competition among governments**

by

**Pierre Salmon\***

**LATEC  
Université de Bourgogne  
2 boulevard Gabriel  
F-21000 Dijon (France)  
pierresalmon@compuserve.com**

**Abstract**

Intergovernmental yardstick competition is based on voters comparing the performance of their own elected government with what obtains in other jurisdictions. This mechanism can produce results that are favourable to voters but it may also be the case that it has consequences that are not favourable. Both cases are given some attention in the essay. Some of their implications for the assignment of powers in the European Union are then derived.

JEL Classification: D72, H73

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\* Without implicating their authors, I am extremely grateful for the very useful comments made on an earlier version of the paper by Jorn Rattsø and by the participants in the conference on European Governance organized by the Center of Law and Economics of the University of Saarbrücken, 10-12 October 2002.

## **I. Introduction**

Intergovernmental yardstick competition is the name given here to a mechanism that may mitigate the problems of information asymmetry faced by voters in their relationship with elected office-holders and generate or reinforce among the latter incentives that are in general favourable to the former. However, in some circumstances, this type of competition may make things worse from the standpoint of voters. As long as there are several governments (at any level, whether municipal, regional, national or supranational), yardstick competition between them will always take place, in a way especially visible when these governments are democratic. Thus, it is above all a natural mechanism or phenomenon, and only secondarily or not at all a treatment that we may or may not wish administered, depending on whether it is curative or noxious. Only at the margin can something be done to strengthen or weaken its effects, or to align them more closely with the interests of voters. Both the possibility that the mechanism serves well these interests and the possibility that it does not deserve attention.

This essay is an attempt to derive implications of the mechanism on the assignment of powers among levels of government in the European Union (EU). There are other, better known, approaches to this question. The aim of the paper is limited. It consists in introducing in the discussion about assignment a new consideration in addition to those already present.

The basic mechanism is exposed in the next section and three particularly important aspects or characteristics of it discussed in Section 3. Section 4 addresses the question of why or how the mechanism can have effects that are unfavourable to the interests of voters. Implications for the design of the EU governmental system are drawn in section 5. Concluding remarks are offered in Section 6.

## **II. Intergovernmental yardstick competition: the basic mechanism**

The mechanism is exposed in an informal way, albeit in some detail, in SALMON [1987].<sup>1</sup> Formal models have been proposed since then, the most influential being the one proposed and tested in BESLEY AND CASE [1995]. But there may be some advantage, in terms of robustness and versatility, in starting our reflection here from the informal account.

The past performance of politicians in power has some influence on the probability of their re-election and, therefore, on their incentives while in office. In a world in which there are many disturbances and change, as well as uncertainty, it is difficult, however, for voter X, located in jurisdiction A, to decide, given circumstances that X does not know, whether and to what extent the performance of the government of A is good or bad. Observing what obtains in some other jurisdictions may help X to form an opinion on that question. This follows from disturbances not being wholly idiosyncratic to the jurisdiction but, to a sufficient degree, common to - or correlated across - different jurisdictions. If the performance of the government of A, in domains of interest to X, is perceived by X to be superior to that observed in some other jurisdiction(s) that X considers as comparable in a relevant way, this may increase the probability that X will vote for the incumbents in A at the next election. Conversely, if the performance of the government in A is seen by X as inferior, this may decrease somewhat the probability that X will vote for the incumbents. Office-holders in A do not know exactly what are the domains which X, or any other voter, will be mostly interested in, nor with which other jurisdictions will X be the most inclined to compare what obtains in A. However, they know that exerting themselves as much and in as many areas as possible enhances the chance that their performance will be judged comparatively good by the voters of their own jurisdiction, and thus increases the probability that they will win the next

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<sup>1</sup> In SALMON [1987], the exposition was inspired by the then recent literature on contests and tournaments, in particular LAZEAR AND ROSEN [1981]. The mechanism was referred to as "rank-order" competition. "Yardstick competition" was mentioned only incidentally in the article. It became widely referred to, in the literature on organisations and incentives especially, under the influence of SHLEIFER [1985]. For our purpose, the difference between tournaments and yardstick competition does not matter very much. For convenience, I choose the latter term.

election. Because winning the next election is an essential objective of incumbents, this generates among them an incentive toward good performance, and moreover performance of a kind that tends to be aligned with the way voters themselves perceive their interests.

Does the mechanism find some support in empirical work or, more generally, is it plausible? In the informal formulation of the mechanism used above, it has not been necessary to specify exactly what were the variables about which comparisons by voters were made across jurisdictions. Some voters may be concerned only with policies of support to music or to sports, others, or the same, with the rate of unemployment. Somewhat in the spirit of the probabilistic theory of voting, politicians being uncertain about that is an essential part of the mechanism which induces them to do their best overall, or on as many issues as possible.

Modelling and empirical testing, though, require more precision. In SALMON [1991], [1997], the main variables are mostly of a macroeconomic kind (unemployment, inflation, and, especially, rates of growth). For the purpose of empirical testing, especially at the sub-national level of government, taxation is a particularly obvious or convenient variable - see BESLEY AND CASE [1995], ASHWORTH AND HEYNDELS [1997], REVELLI [2002]; FELD, JOSSELIN AND ROCABOY [forthcoming]. However, inasmuch as public spending is related to taxation and gives citizens some utility they are aware of, considering only taxation may lead to underestimate the empirical relevance of the mechanism. Solutions that are likely to be more difficult to make operational but are much more intellectually satisfactory take into account the connection between benefits and taxes, as in BRETON [1996], [2002] and BRETON AND URSPRUNG [2002]. In any case, formal testing of the yardstick competition mechanism is clearly difficult. In addition to the problem of finding variables that are both measurable and satisfactory with regard to theory or common sense, there is the usual problem of the existence of other possible hypotheses accounting for the same observations. It is thus quite

remarkable that the very ingenious work done to overcome these difficulties has on the whole provided some empirical support - hardly striking, albeit significant - to the hypothesis.<sup>2</sup>

A quasi-philosophical problem which is not often mentioned in this context but which nonetheless underlies many of the difficulties of testing is that, in the actual, non-experimental world which is by necessity considered exclusively in the empirical studies, there is not enough variation of performance for the mechanism and its effects to really come to the fore. This is not purely accidental. An ontological reason is that the mechanism works at a deeper level of reality than the one observable empirically (except if one could observe politicians' reasoning, so to say, directly). In many settings, yardstick competition, if effective, will have even a tendency to cause its own disappearance from the universe of manifest phenomena. At the limit, if the mechanism worked perfectly, all the observed differences in outcomes would be related not to differences in the variables (such as effort) which are the targets of the mechanism, but to chance, compensations, or variables which the observers neglected but had some importance for voters. Thus, to assess the empirical relevance of the mechanism, it seems inevitable to have recourse also to other, much less formal means, such as casual historical information or thought experiments and counterfactual reasoning. Would the Communist regimes have survived if they had not been submitted by the people they ruled to performance comparisons with what was obtaining in the West? How would voters assess government in a one-government world submitted to historical change? Would the United States have developed all these checks and balances if it had been from the beginning a society intensely open to international comparisons of performance?<sup>3</sup>

### **III. Three particularly important characteristics of the mechanism**

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<sup>2</sup> See in particular BESLEY AND CASE [1995], ASWORTH AND HEYNDELS [1997], REVELLI [2002], BORDIGNON, CERNIGLIA AND REVELLI [2002].

<sup>3</sup> See SALMON [1991].

These characteristics are singled out here not only because of their intrinsic importance but also because, as we will see later, they may have interesting implications in the EU setting.

### *Competition by innovation*

The first characteristic stressed here is that yardstick competition does not involve only quantitative variables, such as the level of taxation, income per head, or the rates of inflation and unemployment. It also takes place by the means of innovations and experiments. Under assessments based on comparative performance, a government which innovates may run a higher risk than it would without this type of assessments, but it may also expect a higher reward in case of success. To illustrate, if an innovation introduced by the government in jurisdiction A is likely to be admired in jurisdiction B, this generates potentially an unfavourable electoral effect on the incumbents in B, but when these incumbents, to avoid the negative effect, imitate the innovation, this provides voters in A with an indication that the innovation was worthy and thus it normally increases somewhat the probability that they will vote for the incumbent.

For the mechanism itself, taking into account experimentations and innovations is at the same time a complicating factor and a source of increased strength or plausibility. Let me start with the latter. The rapidity and intensity with which innovations introduced by national, regional, and municipal governments are commented upon and imitated in other jurisdictions is a major argument in favour of the relevance of the mechanism. Outside economics, the increased scope for policy or institutional experiments allowed by decentralisation has always been considered one of its most obvious attractions. This is now increasingly acknowledged in economics also - as is clear, for instance, from the use of the expression "laboratory federalism" (OATES [1999]). At the same time, competition by innovation is a complicating factor in the sense that it increases heterogeneity and makes objective comparisons more difficult. Not all successful innovations are imitated, they often generate only adjustments in

existing arrangements. For that reason or for more general ones, the policies and institutions used by governments to address problems that are in part similar are, at any point in time, very varied. Even when some forces, yardstick competition in particular, are operating to make them converge, the incessant occurrence of new experiments and innovations disrupts such tendencies and ensures that heterogeneity persists. As a consequence, the task of comparing performance is more difficult, both for voters and for specialised observers. This would constitute a serious objection to the yardstick mechanism only if we had not made from the start uncertainty, both among voters and among politicians, one of its essential features.<sup>4</sup>

### *Variable strength*

The second feature is a high degree of variability in the strength of the mechanism. For a given jurisdiction, that strength is a function of two things: the degree of competitiveness of the political system of that jurisdiction and the informational openness of the jurisdiction (SALMON [1997]). To start with the first, for a given set of comparative assessments made by the voters of a jurisdiction, the influence of these assessments on the incentives of office-holders is related to the nature and intensity of electoral competition within that jurisdiction. When the political regime is such that electoral competition is very strong, with incumbents and the opposition having more or less the same probability of winning, each voter (or category of voters) will tend to count. Thus, the slightest chance of inducing a change in the probability that a voter will support the incumbents will be an object of attention by the latter, and will tend to be taken into account in the process of policy-making. Conversely, if incumbents face an electoral constraint which is weak - because of some feature of the electoral system, *clientélisme*, the fragmentation of the opposition, a structural bias in the distribution of votes (following some ethnic or religious divide, for instance), and many other

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<sup>4</sup> There are many other sources of difficulties for making comparisons across jurisdictions. An important source is the absence of transparency in the financial relations between a central government and sub-central ones, see BROGIO [2002]. Problems of another kind stem from the existence of political parties that straddle jurisdictions; see WREDE [2001] for a very interesting analysis of different situations that can emerge then.

possible reasons - exactly the same assessments by voters may have a much smaller effect on incentives. Then, political yardstick competition will be less effective.

This will not deprive it of its actual or potential relevance, however. Whereas under the first, highly competitive, political regime, a small level of potential discontent may have a very significant effect on incentives, to get the same effect under the second regime will require a higher level of potential discontent. In the second case, office-holders may feel free to remain unconcerned with the satisfaction of a part of the population but there is a limit to this freedom - as history documents abundantly (even in the case of undemocratic regimes).

As noted, one must also consider the informational openness of the jurisdiction. Here the relation whose strength matters is that between objective variations in comparative performance and the variations in subjective assessments that do or do not follow. Material or technical barriers to information may constitute one cause of weakness in that relation: the performance of a country is, say, pretty bad, but voters do not have access to the information. The willingness of voters (or absence thereof) to take into account comparative performance constitutes perhaps an even more important factor. For various reasons - for instance, permanent superiority of the jurisdiction in the relevant area, or the feeling thereof, or sheer complacency - voters in some jurisdictions may be inclined to disregard what happens elsewhere. In other jurisdictions, voters prove extremely attentive to the same type of information. This means that the same level of objective performance gap can lead to almost no discontent in one jurisdiction and to considerable discontent in another. Important differences in the effectiveness of yardstick competition ensue. In jurisdictions in which voters are prevented from making or unwilling to make comparisons, office-holders will not feel very much constrained, even though, there also, there will be a limit to the discretion they enjoy.

By considering together the two dimensions, we get a typology, with cases in which their characteristics tend to compensate each other, so that their overall impact (positive or negative) on the effectiveness of yardstick competition is not very significant, and cases in which the impact is significant because the characteristics along the two dimensions add up.<sup>5</sup> That discussion does not address the question of what happens when informational openness is different across policy areas. This interesting topic will be taken up in the next section.

### *Vertical competition*

Let us turn now to the third feature stressed because of its importance. Yardstick competition among governments is easier to understand and analyse when that competition takes place on the same level of jurisdiction - say, among national governments, or regional ones, or municipalities. However, competition between governments situated on different levels, that is vertical competition, can also take the form of yardstick competition (it can also take other forms, such as competition for the same tax base, or the same source of grants).<sup>6</sup> For instance, voters in Saarland may compare the performance of the government of that Land, not only with what they perceive of the performance of the government of, say, Bavaria (horizontal competition), but also with what they gather from the performance of the federal government (and vice versa).

Vertical yardstick competition is important (BRETON [1996]). It raises a number of issues though. Above all perhaps, there is, again but in a different setting, the question of what is compared. The traditional literature on federalism or decentralisation suggests a relatively strict division of responsibilities among tiers - both as a description of what is, and even more often, as a prescription for what ought to be. This might seem to be an obstacle to comparing governmental performance across levels. In fact, governments on different levels typically operate to some degree in the same policy areas (security, social policies, support to cultural

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<sup>5</sup> An illustration or application of such a typology can be found in SALMON [1997].

<sup>6</sup> An interesting, albeit very particular, form of vertical yardstick competition is considered in BODENSTEIN AND URSPRUNG [2001].

activities, etc.). They are able to do this because they officially share some powers or responsibilities, because the assignment of powers is ambiguous, or because they use different powers to intervene in the same policy area. Moreover, potential entry across levels in a policy area is enough to generate incentives. Suppose the government of jurisdiction A is the only one in the jurisdiction to deal with some important issues in policy area X. Now, the office-holders in jurisdiction B (situated either on a higher or on a lower level) may think that they could do better than the people in power in A to deal with the said issues (as they arise in A). If the office-holders in A think that the danger of invasion is serious, that the invaders would be efficient, and that voters of A would notice the difference in performance, their concern with the probability to win the next election would generate among them an incentive to improve their own performance, and this even if in fact the invasion does not take place.

The foregoing argument refers to comparisons of services offered by different levels of government in the same policy areas. There is another possibility. Comparative assessments may be possible also as a consequence of voters being concerned with indicators of the degree of connection between benefits from public services and tax prices (BRETON [2002], BRETON AND URSPRUNG [2002]). If some voters feel that this connection is tighter in other jurisdictions (whatever the levels on which they are situated) than it is in their own jurisdiction, this might reduce the probability that they will vote for the incumbents at the next election. A variant of that is when voters compare simply some general characteristics - such as speed, reliability or courtesy - of the way services are provided by government services situated at different levels.

Another issue is the effect of vertical competition on horizontal competition. Because governments on different levels of jurisdiction intervene in the same areas, horizontal comparisons may be more difficult, especially if the higher-level government engages, as claimed by BRETON [1996], [2002] in policies that are not uniform across lower-level

jurisdictions (see BROSIO [2002]). As noted earlier, however, uncertainty is not only tolerated by the comparison mechanism but central to it.

A very important question is that of the entrenchment of the rights of the different governments. Vertical relations between levels of jurisdiction are typically asymmetric and unequal. Thus, if the central government does not want the lower-level governments to look more efficient than it does itself in the eyes of voters, and if there is no entrenchment of the rights of these lower-level governments, the central government can change the law or reduce the funds available at their level so that they will not win the race. In systems that are not merely decentralised but really federal, level-2 governments enjoy some constitutional or quasi-constitutional protection against the deeds of the central government. This makes vertical competition easier to figure out in federations than in unitary states (but see Salmon, 2000).

#### **IV. Negative effects of intergovernmental yardstick competition**

##### *Recent theoretical objections to the virtues of the mechanism*

Several recent papers (BELLEFLAMME AND HINDRICKS [2001], BESLEY AND SMART [2001], BORDIGNON, CERNIGLIA AND REVELLI [2002]) raise objections to the presumption that yardstick competition (or, more generally, performance comparison) is generally favourable to citizens or voters. It is not the place here to engage in a detailed examination and discussion of this very recent work. Let me tentatively say, as a first impression, that, even though it seems clear that there are circumstances in which the presumption should be of negative effects rather than of positive ones, I am not sure that the causes leading to that should be sought mainly in the direction followed in this recent work. One reason is that the context in which this work assumes the voters to be placed is that of a need to select, among politicians, "good" types when there are also "bad types" around - the difference between the two,

moreover, not being about competence but about something like morality. This is certainly a very relevant question at some level of generality and under some institutional arrangements. But I am not sure that either of the conditions is satisfied here - where, more or less implicitly, our underlying assumptions, inspired by tournament theory, are that all politicians are the same (that is, in a sense, all equally "good" or "bad") and must be induced to provide more attention and effort to the needs expressed by voters. In other words, our problem is one of moral hazard, not selection.

Dynamic incentives, also referred to in this literature, are another matter. In MEYER AND VICKERS [1997] implicit incentives in a dynamic setting have an influence on behaviour which may be the opposite of the incentives produced by performance comparisons in a static framework. The overall effects appear thus to be ambiguous. The idea underlying the precise argument seems quite general and might have a lot of relevance for our purpose. It remains to be seen, however, whether it will yield the same ambiguity when applied to a political setting in which the principals are voters, instead of regulators and their relations with politicians (not firms) necessarily pursued under incomplete contracting. An important consideration, in this context, might be whether politicians who lose an election are assumed to be eliminated forever or may be candidates again in the following elections (see WREDE [2001]).

#### *Perverse mimicking*

Yardstick competition will lead to convergence. No government can afford to do less well than others. But there might be multiple equilibria. Even without collusion among the governments concerned, it may be the case, especially when there is a small number of jurisdictions that can be compared, that convergence and equilibrium obtain at a level which is not the most efficient from the perspective of voters but which the governments involved may find preferable. In an equilibrium of that kind, governments make less effort or, by the

way of increased taxation or of reduced spending on objectives voters share, manage to use resources for their own ends.<sup>7</sup>

More casually, we can observe that comparisons are often asymmetric. In a number of jurisdictions, voters compare the performance of their own jurisdiction mainly with what obtains in one jurisdiction, A, singled out among several possibilities. Country A, say, is used as a kind of benchmark by voters and public opinion in several other countries. Now, if A under-performs, this may reduce very much the political stakes involved in yardstick competition for the governments of the other jurisdictions. They feel free to relax, and thus the whole group under-performs compared with jurisdictions outside the group. Again, there is an equilibrium of low performance (see SALMON [1991], [1997]).

#### *Multi-task jobs*

An equally or even more important problem for yardstick competition, and, at the same time, one which is also particularly likely to suggest interesting propositions for the allocation of powers across levels, originates in the fact that comparative assessments are much easier in some policy areas, or for some aspects of policies, than they are in other areas or for other aspects. As a consequence, an incentive is generated for governments to devote more attention and effort to the policies, or aspects thereof, whose assessments are easier. If yardstick competition is very intense and successful in the areas in which assessments are easy, other policies, or other aspects, may as a result get completely sacrificed. For instance if governments compete intensely in terms of growth, they may neglect income distribution or other social considerations (SALMON [1997]).

This is clearly very much related to the work done, in the literature of labour economics or the economics of organisations, on the problem of multi-task jobs (HOLMSTROM AND MILGROM [1991], DEWATRIPONT, JEWITT AND TIROLE [2000], SEABRIGHT [2000]) - except

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<sup>7</sup> FELD, JOSSELIN AND ROCABOY [forthcoming] argue that something of that kind has happened at the level of regional governments in France.

that this work compares the measurability of performance across tasks and analyses its effects on the allocation of effort but does not introduce yardstick competition. Combining the two ideas seems feasible though. The solution proposed by Holmstrom and Milgrom is to design jobs in view of limiting the bias toward the most easily measurable tasks. One way to achieve this is to separate the tasks that are subject to easy assessments from those in which measurement is difficult - that is, to create different, more homogeneous, jobs. LAZEAR [1995, p. 87] accepts the validity of the idea in principle, but does not believe it to be very relevant in practice because, according to him, jobs are based first of all on technical complementarities. When the separation of tasks is impossible or too costly, then, Holmstrom and Milgrom's solution to avoid the bias is to remain content with low-powered incentives.

The foregoing reasoning can be coupled with differences in the feasibility of yardstick competition overall. In SALMON [1991], two groups of policies and two pure cases of feasibility of comparisons are considered together. They are, respectively, macroeconomic policies versus "transactions with interest categories", and countries being "informationally open" versus countries being "informationally isolated or closed". The idea is that change in the easiness of yardstick competition will affect considerably the assessment of macroeconomic policies but not much that of transactions with interest categories. Therefore, when a country is informationally isolated, and thus when its policies are not easily submitted to comparisons with those of other countries, the assessment of performance with regard to transactions with interest categories is much easier than the assessment of performance with regard to macroeconomic policies. This creates a bias in the incentives of the government, which does not devote enough attention or resources to macroeconomic outcomes and too much to interest categories. But when a country is very open to international comparisons, this will affect macroeconomic variables more than it affects transactions with interest

categories. As a consequence the bias will consist now of paying too much attention to macroeconomic variables, and not enough to interest categories.

Another application of the multi-task idea is to leadership.<sup>8</sup> Assume that there is an international public good subject to free riding on the part of nation-states. As argued forcefully, many years ago, by KINDLEBERGER [1976], leadership by one country may be necessary for an international public good (such as peace, economic stability, freedom of navigation, free trade, etc.) to be produced. Assume that the production of the public good is in the long-term interest of voters in the country which could play the role of leader, but that voters are unaware of this. If yardstick competition is so intense that the government of the would-be leader country is constrained to devote all its resources to the production of the goods and services that are the objects of the comparative assessments of voters, nothing will be left for the leadership task, which therefore will not be fulfilled. In that case, less intense yardstick competition might well be beneficial to all.

## **V. Implications of yardstick competition for the governance of the EU**

A large part of the implications of yardstick competition for the governance of the EU are implicit in the foregoing discussion provided we add some fairly well-known facts about the EU and its member countries. Implications are made explicit below in the form of six propositions. In each case, the proposition should be read with the more general argument, formulated in the earlier sections, in mind.

PROPOSITION 1:

*An effect of yardstick competition between the member countries of the EU is to make unlikely in the medium-term any substantial divergence in income per head.*

The political regimes of member countries of the EU are very competitive in the sense that incumbents are far from feeling certain to be re-elected at the next election. This means

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<sup>8</sup> See SALMON [1992].

that they will be attentive to the views of all sectors of opinion. Comparative assessments of macroeconomic performance are easy to make between these countries and, in fact, are the object of significant attention by the media and public opinion, or subsets thereof. Thus, with regard to macroeconomic performance, the two conditions noted earlier are met for yardstick competition to be effective. Casual evidence from the public debate confirms this. The observation of the convergence of income per head among EU member countries also provides support.

This convergence is striking but it could be caused by other factors. Hence the very cautious formulation of Proposition 1. Yardstick competition would create in a country strong political incentives to prevent it from falling behind in a substantial way in terms of macroeconomic performance. This does not apply of course to short term divergence. What one should have in mind here is the kind of evolution experienced by countries like Argentina or Spain, when their incomes per head were brought down from a level roughly comparable to that of France or Germany to the third or half of that (SALMON [1997]).

PROPOSITION 2:

*A major task of the EU institutions should be to provide (or to ensure that others provide) comparative information and analysis in all policy areas.*

The rationale for this task is also fairly obvious. In areas other than macroeconomic performance, comparisons are difficult to make, with the difficulty increasing, as already noted, when competition or emulation takes the form of innovation or experimentation. At any moment in time, the policies or arrangements offered in the various countries will tend to be different. For instance, very different welfare systems or social policies have been put in place by EU member countries (BERTOLA ET AL. [2001]). There are often compensations, however, so that completely different means may produce in the end results that are not so dissimilar. As a consequence, to provide citizens in the various countries with the kind of

information they need to gauge the comparative performance of their government will require a lot of analysis and assessment. This feature of information supply increases the need for objective sources, as independent as possible from the governments whose policies are scrutinised.

It is probably difficult for the Commission or any other independent institution at the EU level to frame comparative information directly in term of rank-order assessments (that would make it too exciting). But the information produced should allow other agents or organisations (the media, universities, etc.) to do so. The objects of comparisons should be first of all the policies implemented by the member-states governments, but they could include, at lower levels of jurisdiction, those of the regional and municipal ones. The information should be supplied for free, and even some cost incurred to make it as widely available as possible. In addition, increased support should be devoted to programmes which have, among other effects, that of facilitating comparative assessments. Examples of such programmes are the spread of English as a common working language and the funding of studies abroad.

PROPOSITION 3:

*For the sake of yardstick competition, tolerance of some fragmentation of the EU market and of some distortions of competition should be maintained or increased.*

This is also an implication of innovation-rich yardstick competition. Such competition necessarily fragments the economic space of the EU. Innovations, and more generally government decisions at a sub-central level, typically create additional transaction costs for private-sector activities that straddle jurisdictions and additional rents for those that do not. In the language of international trade theory, this means that innovative governments create non-border, non-tariff barriers to trade. Since the Single Act, this fragmentation runs against a

major undertaking of the EU, which is to eliminate *all* barriers to trade, including all non-border, non-tariff barriers.

The capacity of the national and sub-national governments to innovate, or simply to act, is also constrained by another aspect of the single-market programme, which is to implement “fair competition” and a “level-playing field”. Subsidies by governments to firms, often referred to in the literature as “state aids”, may distort competition and thus are at least suspect and often banned under this aspect of the programme.<sup>9</sup>

If yardstick competition is of some value, then the implication is that a compromise is necessary between the objective of enhancing it and that of eliminating all barriers to trade and all distortions to competition. The observation of countries in which intergovernmental competition at the sub-national level is intense, such as Canada, the United States or Switzerland, shows that a more liberal interpretation of free internal trade and “fair competition”, or of the establishment of a “level-playing field”, are perfectly compatible with a high degree of political integration and market competition.<sup>10</sup>

PROPOSITION 4:

*A perverse effect of yardstick competition may be that equilibrium growth in the EU is too low; to move it up, more power in the area of economic policy-making should be given the Commission.*

We saw earlier that a low-growth equilibrium can be the result of yardstick competition taking the form of “perverse mimicking”, especially (but not necessarily) when comparisons are asymmetrical (citizens of A compare with what obtains in B but the reverse is not true or not to the same extent). It seems quite possible that this phenomenon is a cause of the present situation in Europe, as it was already in the first half of the 1980s. If we consider France and

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<sup>9</sup> On all this, see BRETON AND SALMON [2001] and SALMON [2002a], [2002b].

<sup>10</sup> See MUELLER [2000] for a convincing criticism of the “fair competition” argument against regional government subsidies to private firms. TABELLINI [2002] acknowledges the existence of a trade-off or dilemma between the goal of decentralizing policy-making and that of eliminating all barriers to trade and distortions of competition but his position is that in each case when they conflict the first goal should be sacrificed.

Germany, there is some empirical evidence that any differential in macroeconomic performance between these countries has a significant effect on votes in France but not in Germany (see LEWIS-BECK ET AL. [2001]). If this can be generalised to other member countries, this means that special circumstances that generate relatively low growth in Germany will have the effect of making growth in the EU as a whole relatively low.

Things would be different if voters in the EU compared growth in the EU as a whole with growth elsewhere, in particular in the United States, but also in Asia, and if the rate of growth there was high. It is argued in SALMON [1991] that this kind of comparisons in the early 1980s may well have been at the root of the feelings about "Europessimism" and "Eurosclerosis", which in turn seem to have played a role in the adoption of the Single Act and the 1992 project.

If there is some truth in this hypothesis, then, ways to redirect the attention of voters to comparisons of performance in the area as a whole with what obtains elsewhere may help escape the low-growth equilibrium trap. To achieve this, more responsibilities with regard to the governance of the economy could be given to the Commission than seems justified on other, more conventional grounds. For instance, even if the utility of coordinating economic policies is denied on purely conventional economics grounds, as some economists do (e.g., TABELLINI [2002]), there might still be some argument, related as indicated above to yardstick competition, in favour of assigning a coordinating task to the Commission.

PROPOSITION 5:

*In the current state of European integration, there is not much scope for vertical yardstick competition to be enhanced.*

We saw that vertical competition needs constitutional protection. It is tempting to apply that to the EU. Usually, the idea is that the most central government is the one to be protected against (there is a centralisation tendency in most existing federations). Thus it is tempting to

argue that, for vertical competition to remain fair or stable, national governments should be protected against Brussels. In fact this reasoning is quite widespread (see, for instance, VAUBEL [1999]). But this line of reasoning runs against European being under construction, so to say. We are not at equilibrium and thus cannot apply rules now that make sense only at equilibrium. The European integration project, officially aiming at "ever closer union", is based on the dynamics of reallocating increasing powers or competences at the EU level and is thus not really compatible with the idea of a stable or fair vertical competition between the governments of the member countries and Brussels. Ironically, one may argue that if a level is to be constitutionally protected, this is the EU level - and in fact it is protected to some degree thanks to "ever closer union" being included in constitutional or quasi-constitutional documents, and thanks to the *acquis communautaire* principle.

PROPOSITION 6:

*To protect some worthy tasks from a perverse effect of yardstick competition, one might want them to be removed from the national governments.*

We saw that high-powered incentives such as those brought about by yardstick competition may lead, in the case of multi-task jobs, to a bias in favour of some of the tasks, the other being neglected. This has certainly very important potential implications for European governance, even though they will not be spelled out here. We noted that complementarities may be an argument against designing single-task instead of multiple-task jobs. Where complementarities are not too strong, the merits of single-task jobs might inspire a criterion for judging ex post the separation of tasks among levels. This point is related in an interesting way to one made by BERTOLA ET AL. [2001, p. 103]:

"A problem with shared decision-making is that a particular decision may never be important enough in any particular government tier, even if it should be implemented from an overall point of view. For example, spending on minimum social protection or on family support measures may be crowded out by policies receiving stronger support at each decision level, despite its desirability from an ex ante point of view. In such cases (as in the case of monetary policy delegated to an

accountable and independent central bank), the government tier or institution with the highest degree of commitment should be identified at an equally *ex ante* constitutional stage and receive a clear mandate to target a specific problem."

Yardstick competition may be the mechanism that explains why some concerns are crowded out, and to that extent our approach is convergent with that of BERTOLA ET AL.<sup>11</sup> However, the question of complementarities cannot be glossed over in the context of the EU. As noted by PERSSON, ROLAND AND TABELLINI [1997], it is central to the spillover strategy which has been followed until now for the purpose of integrating Europe (see also SALMON [2000b]). The problem of finding tasks that can be separated and reallocated without weakening the drive toward a more integrated EU is thus worth addressing but necessarily complex. Achieving such separation at a constitutional stage seems very problematic. *Ex post* assessments and discussions seem a more realistic alternative on this matter as on many others that are the objects of theoretical reasoning.

## **VI. Concluding remarks**

When economists have felt qualified to contribute to the question of the assignment of responsibilities among levels of government in the EU, their main instrument has usually been the theory of fiscal federalism as exposed a long time ago by Richard Musgrave and Wallace Oates. In the context of the European Union, the theory is now fairly generally considered as of limited use (PERSSON, ROLAND AND TABELLINI [1997]). It suggests centralisation in areas, such as foreign policy, defence, or income redistribution, in which there is little of it so far and in which having more in the near future proves extremely difficult. Even though this is not a fatal flaw in a theory which is mainly normative, this lack of influence suggests the

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<sup>11</sup> We saw earlier that another illustration of the possibility that yardstick competition could prevent governments to devote sufficient attention to certain tasks is when a country which could fulfil a role of leader, provided it devoted sufficient resources to it, is prevented to do so by the pressure of competition. In SALMON [1992], this was applied to the role of Germany in the EU. For sufficient resources and attention to be devoted to some tasks in the field of foreign affairs it may thus be useful to escape the competitive pressure to which governments are submitted by transferring the tasks, or part of, to the Commission in Brussels, and this even if, on other grounds, such transfer does not seem very justified.

possibility that the theory misses some important considerations. Three such considerations (at least) can be found in the economic literature. First, many of the problems created by decentralised policy-making can be solved at the same level of jurisdiction by negotiation or coordination between some or all of the governments situated at that level. Whether this is more efficient and thus more likely to obtain than centralising the policies at a higher level depends on transaction costs of various kinds, as explained in detail by BRETON AND SCOTT [1978].<sup>12</sup> As I have stressed elsewhere, it is particularly noteworthy in the case of decision-making in the EU that a large part of negotiations takes place under a perspective of repeat-business and - to borrow an expression coined or used by COOTER [2000, p.120] - “splicing issues.”<sup>13</sup> A second consideration is the degree of heterogeneity of preferences on each issue across member entities or, in the EU context, countries. It is given a place in some recent work on the assignment of powers (see ALESINA, ANGELONI AND SCHUKNECHT [2001] and the references therein).

The third missing consideration is politics, and the way it can be analysed in economics - often referred to as “public choice”. Decisions in the public sector are made by individual actors who have their own goals and make decisions under conditions of uncertainty, information asymmetry and incomplete contracting. Thus, even under a normative approach, one should reason in a world of second-best. More intuitively, it is in a messy world akin to the real one that genuinely convincing reasons for decentralisation and federalism can be found. And it is in such a world that intergovernmental competition appears no more as a force complicating or disrupting the otherwise efficient arrangements prescribed by normative theory, but, under a perspective of positive economics, as an essential ingredient in the explanation of how democratic governmental systems operate.

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<sup>12</sup> See also INMAN AND RUBINFELD [1997, pp. 96-101].

<sup>13</sup> This has very important consequences, as argued in SALMON [2002a]. For instance, it explains that even under unanimity rule, decisions at the level of the EU are very far from being generally plagued by a tendency to adopt the lowest-common-denominator solution, as has often been unjustly claimed. Many policies have been adopted unanimously even though they displeased a majority of member countries.

Now, there are at least two forms of intergovernmental governmental competition, the most frequently studied and referred to being by far competition based on the mobility across jurisdictions of individuals, factors of production and business firms. If the government's policies in jurisdiction A do not please individual or firm X as much as would policies adopted in some other jurisdiction B, X might move to B, an event that the government of A will generally want to avoid. This paper has focussed on another other form of intergovernmental competition: yardstick competition. Even more clearly than mobility-based competition, its relevance stems from the existence of imperfections in the political process. Do the two forms of competition add up in favour of voters or does mobility erode the capacity of governments to act and thus in the end hinder yardstick competition? This important question is addressed a little, in the context of the EU, in SALMON [2002a] but a much more deliberate attempt at tackling it is needed.

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