

# THE PRINCIPLE OF SUBSIDIARITY AS A PRINCIPLE OF ECONOMIC EFFICIENCY

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*The principle of subsidiarity—whereby a power shared between the European Union and its Member States is exercised at the lowest appropriate level of governance—is a general principle of European Union law the justiciability of which has been widely discussed. The justiciability of the subsidiarity principle has been criticized for underlining its political relevance. However, this critique lacks the power to explain both the weight of the principle of subsidiarity in the E.U. Treaties and the case law regarding the subsidiarity principle. What is the principle of subsidiarity and what degree of justiciability does it have?*

*This paper argues that the principle of subsidiarity is better understood in its current form when its economic complexion is underlined. More precisely, the principle of subsidiarity contains, at its core, the principle of economic efficiency. The “subsidiarity-as-efficiency” model offers a better understanding of European Union law and reveals that the European case law on subsidiarity tends to promote economic efficiency.*

*The article shall introduce the basic notions of the E.U. principle of subsidiarity before (I) delving into the efficiency rationale of the subsidiarity principle. Next, (II) the article shall study the European case law and show that the principle of economic efficiency is clearly encapsulated in this jurisprudence, which renders the European case law on the principle of subsidiarity economically sound with respect to promotion of efficiency through subsidiarity. The article will be concluded in Part III.*

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## INTRODUCTION

Subsidiarity is a controversial principle that the European Union endorsed only recently. Despite its recent interest to academia and the press, the principle of subsidiarity stems from Greek philosophy, Aquinas' writings, seventeenth century German corporatists, and, most influentially, the Catholic Church's social doctrine.<sup>1</sup> The principle of subsidiarity refers to notions of multi-level governance<sup>2</sup> and of regulatory competition.<sup>3</sup> The human rights analysis of the principle of subsidiarity focuses on the protection of human dignity and political diversity by defining the principle of subsidiarity as a "structural principle of international human rights law."<sup>4</sup>

The principle of subsidiarity is double-edged; it can be used to justify both increased centralization and increased decentralization. The principle of subsidiarity can justify further centralization because it requires that the most appropriate level of governance be chosen for exercising a particular power. The most appropriate level of governance can either be a higher level of decision-making (i.e. supranational or federal), which would support increased centralization, or a lower level of governance,<sup>5</sup> which would support decentralization.<sup>6</sup> As the common understanding

<sup>1</sup> ANTONIO ESTELLA, THE EU PRINCIPLE OF SUBSIDIARITY AND ITS CRITIQUE 76 (2005). See generally JEAN-LOUIS CLERGERIE, LE PRINCIPE DE SUBSIDIARITÉ (1997); CHANTAL MILLION-DELSOL, L'ÉTAT SUBSIDIAIRE—INGÉRENCE ET NON-INGÉRENCE DE L'ÉTAT: LE PRINCIPE DE SUBSIDIARITÉ AUX FONDEMENTS DE L'HISTOIRE EUROPÉENNE (1992).

<sup>2</sup> See Liesbet Hooghe & Gary Marks, *Types of Multi-Level Governance*, 5 EUR. INTEGRATION ONLINE PAPERS 4 (2001), <http://eiop.or.at/eiop/texte/2001-011a.htm>; Joel P. Trachtman, *L'Etat, C'est Nous: Sovereignty, Economic Integration and Subsidiarity*, 33 HARV. INT'L L.J. 459, 459 (1992).

<sup>3</sup> NEIL MACCORMICK, CONSTRUCTING LEGAL SYSTEMS: "EUROPEAN UNION" IN LEGAL THEORY 350-52 (1997). MacCormick calls "market subsidiarity" private regulation through subsidiarity and calls public regulation through subsidiarity "rational legislative subsidiarity."

<sup>4</sup> Paulo G. Carozza, *Subsidiarity as a Structural Principle of International Human Rights Law*, 97 AM. J. INT'L L. 38, 40 (2003).

<sup>5</sup> Koen Lenaerts & Patrick van Ypersele, *Le principe de subsidiarité et son contexte: Etude de l'article 3B du Traité CE* IN CAHIERS DE DROIT EUROPÉEN 31-33 (1994).

<sup>6</sup> See Gráinne De Búrca, *Proportionality and Subsidiarity as General Principle of Law*, in GENERAL PRINCIPLES OF EUROPEAN COMMUNITY LAW: REPORTS FROM A CONFERENCE IN MALMÖ 27-28, AUGUST 1999, 95, 111 (Ulf Bernitz & Joakim Nergelius eds., 2000). The subsidiarity principle applies to E.U. legislation, but not to ECJ rulings; hence, the ECJ's credibility with respect to the introduction of the subsidiarity principle does not seem to be lessened; see also JACQUES DELORS, SUBSIDIARITY: THE

of the principle suggests, we shall nonetheless use the term subsidiarity as synonymous with both national and sub-national decentralization in the E.U.<sup>7</sup>

The principle of subsidiarity governs the exercise of E.U. powers when the Treaties provide that the Member States share these powers with E.U. institutions.<sup>8</sup> However, this principle does not convey whether or not the E.U. has the power to act with regard to a specific policy.<sup>9</sup> When the E.U. has a shared competence, the E.U. may only act in compliance with the principle of subsidiarity.<sup>10</sup> Hence, it is never appropriate for the E.U. to act when it has no powers, and it is not always appropriate for the E.U. to act even when it has shared powers for interventions. Enshrined in the European Treaties since Maastricht<sup>11</sup> (and reaffirmed in the Lisbon Treaty<sup>12</sup>), the principle of subsidiarity was primarily designed in response to the expansion of majoritarian voting in E.U. decision-making, which has taken place since the European Single Act of 1986.<sup>13</sup> As discussed below, in Article 5(3) of the T.E.U., subsidiarity is defined, together with the principles of proportionality, as the principles of E.U. governance. The E.U. unsurprisingly interweaves these two

CHALLENGE OF CHANGE, PROCEEDINGS OF THE JACQUES DELORS COLLOQUIUM, 10 (1991). Delors affirmed, regarding the Court's credibility, that "subsidiarity is unfortunately a principle which one applies to others and not to oneself."

<sup>7</sup> See Protocol No. 2 on the Application of the Principles of Subsidiarity and Proportionality, Consolidated Version of the Treaty on European Union, arts. 2, 5, 6, Mar. 30, 2010, 2010 O.J. (C 83) 206 [hereinafter Subsidiarity Protocol].

<sup>8</sup> Consolidated Version of the Treaty on the Functioning of the European Union, art. 3, Mar. 30, 2010, 2010 O.J. (C 83) 47 [hereinafter TFEU]. The subsidiarity principle is applicable in all areas of the Union's competences, except areas dealing with (i) the customs union, (ii) competition policy, (iii) the monetary policy for the eurozone, (iv) common fishery policy, and (v) common commercial policy.

<sup>9</sup> Literature regarding the principle of subsidiarity is abundant. See generally George Bermann, *Taking Subsidiarity Seriously: Federalism in the European Union and the United States*, 94 COLUM. L. REV. 331 (1994); Deborah Z. Cass, *The Word that Saves Maastricht? The Principle of Subsidiarity and the Division of Power Within the European Community*, 29 COMMON MKT. L. REV. 1107 (1992) (delivering a more optimistic critique of the principle); Vlad Constantinesco, *Who's Afraid of Subsidiarity?*, 11 Y.B. OF EUR. L. 33 (1992); Nicholas Emiliou, *Subsidiarity: An Effective Barrier Against "the Enterprises of Ambition"?*, 17 EUR. L. REV. 383 (1992); J.P. Gonzalez, *The Principle of Subsidiarity*, 20 EUR. L. REV. 355 (1995); Guenther Schaefer, *Institutional Choices: The Rise and Fall of Subsidiarity*, 23 FUTURES 681, 688 (1991) (describing this principle as "basically an empty shell devoid of concrete substance"); Akos G. Toth, *The Principle of Subsidiarity in the Maastricht Treaty*, 29 COMMON MKT. L. REV. 1079 (1992); Kees Van Kersbergen & Bertjan Verbeek, *The Politics of Subsidiarity in the European Union*, 32 J. COMMON MKT. STUD. 215 (1994).

<sup>10</sup> E.U. Treaty art. 5(3).

<sup>11</sup> Consolidated Version of the Treaty Establishing the European Community, art. 3b, Dec. 29, 2006, 2006 O.J. (C 321E) 37 [hereinafter EC Treaty]; Protocol No. 30 on the Application of the Principles of Subsidiarity and Proportionality of the Consolidated Version of the Treaty Establishing the European Community, pmb1, 2006 O.J. (C 321E) 308. After being defined in Article 3b of the 1992 Treaty of Maastricht, the subsidiarity principle was then incorporated in Protocol No. 30 of the European Community Treaty by the signing of the Amsterdam Treaty of 1996.

<sup>12</sup> E.U. Treaty art. 5(3) ("Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at the Union level. The institutions of the Union shall apply the principle of subsidiarity as laid down in the Protocol on the application of the principles of subsidiarity and proportionality. National Parliaments ensure compliance with the principle of subsidiarity in accordance with the procedure set out in that Protocol.").

<sup>13</sup> Van Kersbergen, *supra* note 9, at 220.

principles into the same protocol—Protocol No. 2 on the Application of the Principles of Subsidiarity and Proportionality—since both principles regulate the exercise of E.U. competences. Although different Articles of the Treaties refer to subsidiarity, nowhere do the Treaties define the principle of subsidiarity.

This article predominantly argues that the legal vagueness of the principle of subsidiarity is essentially due to its economic ambivalence. The conflict-ridden notion of the justiciability of the principle of subsidiarity mainly results from the innate indeterminacy of its economic consequences.<sup>14</sup> To be sure, the principle of subsidiarity entails diverse efficiency consequences—either gains or losses.<sup>15</sup> It is impossible to know *ex ante*, however, the economic consequences of further subsidiarity for a particular policy. Because of this, only a casuistic approach may define the principle of subsidiarity. In other words, the principle of subsidiarity does not apply neutrally to the principle of economic efficiency; however, considering economic efficiency sheds light upon one's understanding of subsidiarity and its consequences.

At this time, it is appropriate to turn to the proposed illustration of “subsidiarity-as-efficiency” in order to specify the economic consequences of the principle of subsidiarity and explain its efficiency rationale. The principle of economic efficiency elucidates the principle of subsidiarity. In the next Part, the article advocates for the study of the principle of subsidiarity as a principle of economic efficiency.

#### I. THE PRINCIPLE OF SUBSIDIARITY AS A PRINCIPLE OF ECONOMIC EFFICIENCY

This Part of the article claims that the principle of subsidiarity, as enshrined in the law of the E.U., is better understood when the efficiency gains and losses of this principle are envisaged. The accuracy of an economically-minded approach to the principle of subsidiarity counterbalances the inadequacy of the legal and political viewpoints underpinning this principle. Indeed, the European Treaties themselves offer some hints for our study of the relationship between the principle of subsidiarity and the principle of economic efficiency.

This article shall assert that the principle of subsidiarity is simply an economic principle of governance<sup>16</sup> involving at its very core the principle of economic

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<sup>14</sup> Bermann, *supra* note 9, at 343. Bermann details the political virtues attached to the subsidiarity principle, which he sees as: “self-determination and accountability, political liberty, flexibility, preservation of local identities, diversity and respect for the internal divisions of component states.” *Id.*

<sup>15</sup> Gareth T. Davies, *Subsidiarity as a Method of Policy Centralisation* 14 (Int'l Law Forum of the Hebrew Univ. of Jerusalem, Research Paper 11-06, 2005), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=921454](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=921454). Davies argues, without further explanation, that “subsidiarity thus offers the choice between centralisation or co-option. This choice may have efficiency implications which could lead in either direction.” *Id.* at 14. More generally, this author advocates an understanding of the principle of subsidiarity that would be more precise than its usual understanding.

<sup>16</sup> Robert P. Inman & Daniel L. Rubinfeld, *Subsidiarity and the European Union* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 6556, 1998), available at <http://www.nber.org/papers/w6556.pdf>. In the same vein, the authors start their description of the principle of subsidiarity by stating that “[s]ubsidiarity is a principle of governance designed to give meaning to the division of power and responsibility between the central government and constituent states in a federal system.” *Id.* at 1.

efficiency. An examination of economic theory demonstrates the importance of economic efficiency for the principle of subsidiarity in general, and the European Treaties highlight the importance of economic efficiency for the E.U. subsidiarity principle in particular. Thus, if the economic theory shows that the principle of subsidiarity produces efficiency gains and losses (Part I.A), while the European Treaties establish, as discussed below, a comparative efficiency test for implementing the E.U. principle of subsidiarity, we can interweave both principles so that the subsidiarity principle becomes more precise and, therefore, more desirable, due to its underlying efficiency benefits (Part I.B).

*A. Economic Theory of Subsidiarity and of Centralization*<sup>17</sup>

1. Economics of Subsidiarity

As a basic intuition, it is plain that efficiency gains can be reaped from legal decentralization (subsidiarity).<sup>18</sup> Decentralization delivers efficiency gains unless economic criteria justifying further centralization are met.<sup>19</sup> The economic justifications for decentralization hearkens back to the seminal model proposed by Charles M. Tiebout who showed that economic efficiency could be enhanced through political decentralization.<sup>20</sup> Indeed, local governments can more efficiently provide goods to local publics than central governments can. Tiebout argued that when individuals have homogeneous preferences and when taxes only concern those individuals, fiscal efficiency might be achieved without central intervention in a decentralized economy provided that persons and capital are sufficiently mobile.<sup>21</sup> Inter-jurisdictional competition with respect to taxes brings about economic efficiency since public goods are provided up to the amount for which voters are willing to pay for them in each jurisdiction.<sup>22</sup>

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<sup>17</sup> For a survey of the literature, see Fritz Breuss & Markus Eller, *The Optimal Decentralisation of Government Activity: Normative Recommendations for the European Constitution*, 15 CONST. POL. ECON. 27, 29–41 (2004).

<sup>18</sup> For the sake of simplicity, I understand subsidiarity as decentralization since it is this meaning that is officially given in the Preamble of the Protocol No. 2 of the European Treaties. Subsidiarity Protocol, *supra* note 7, pmb.; see also Inman & Rubinfeld, *supra* note 16, at 5–13. Subsidiarity corresponds to what the authors call “decentralized federalism,” and centralization may correspond to what these authors call “centralized federalism.” I will use “democratic federalism” to describe an “optimal multi-tier governance.”

<sup>19</sup> The very idea of optimal local decision-making traces back to Adam Smith. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 680 (R. H. Campbell et al. eds., 1976) (1776).

<sup>20</sup> See Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 424 (1956).

<sup>21</sup> *Id.*

<sup>22</sup> George J. Stigler, *The Tenable Range of Functions of Local Government*, in JOINT ECONOMIC COMMITTEE, U.S. CONGRESS, FEDERAL EXPENDITURE POLICY FOR ECONOMIC GROWTH AND STABILITY 216 (1957) (“Competition of communities offers not obstacles but opportunities to various communities to choose the type and scale of government functions they wish”). Oates takes Tiebout’s model further and argues that, even without mobility of economic agents, regulatory decentralization brings about a more efficient outcome than does centralization of public goods because of heterogeneous preferences across jurisdictions. See WALLACE E. OATES, *MODERN PUBLIC FINANCE* 35 (John M. Quigley & E. Smolensky eds., 1994).

Extra decentralization creates three general efficiency gains.<sup>23</sup> First, decentralization produces a greater variety of regulations. The main costs in designing regulations are the informational costs. The central government can gather the necessary information for drafting regulations and policies and for monitoring their implementation only at a greater cost than the aggregate sum of the costs incurred by local governments for doing so. Information-gathering costs are drastically increased when the central government regulates the economy. This is due to what Hayek called the “knowledge problem”<sup>24</sup>—gathering the relevant and necessary information to police the economy and synthesizing this information on an ongoing basis requires both a high level of detail and a great effort on the part of the central planner. Not only is the central government reluctant to expend the effort to determine the local preferences of voters in order to adapt the regulation to local needs, but the central government still has to overcome “the preference revelation problem”<sup>25</sup> as well. By contrast, when local governments control decision-making, individuals and firms are able to choose the regulation that maximizes their utility. Allocative efficiency increases because agents choose the regulation that best suits their preferences.<sup>26</sup> To illustrate, the greater decentralization of enforcement of the E.U. competition policy takes into consideration the large costs incurred by a central authority when implementing this policy on a European-wide level.<sup>27</sup> In a situation where heterogeneous voters’ preferences are so varied that they do not overlap, decentralization becomes the most efficient solution because it minimizes political costs and maximizes voter utility.<sup>28</sup> The departure from local decision-making increases political costs since central decision makers are unable to take into consideration the heterogeneity of preferences. Thus, “even if the central

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<sup>23</sup> See Jeanne-Mey Sun & Jacques Pelkmans, *Regulatory Competition in the Single Market*, 33 J. COMMON MKT. STUD. 67, 82–83 (1995).

<sup>24</sup> Friedrich A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 519 (1945).

<sup>25</sup> The preference revelation problem refers to the inherent difficulty for policy-makers to extract preferences of individuals with respect to public goods due to the subjectivity of these preferences and their hardly monetized nature. Richard Hemming & Paul B. Spahn, *European Integration and the Theory of Fiscal Federalism*, in MACROECONOMIC DIMENSIONS OF PUBLIC FINANCE: ESSAY IN HONOUR OF VITO TANZI 111 (Dans M. Bleyer & T. Ter-Minassian eds., 1997); H. ZIMMERMANN & K.D. HENKE, FINANZWISSENSCHAFT (2005). Regarding the revelation of voters’ preferences in the E.U. concerning the delegation of powers to the E.U., see Floriana Cerniglia & Laura Pagani, *The European Union and the Member States: An Empirical Analysis of the Europeans’ Preferences for Competences Allocation*, 55 CESIFO ECON. STUD. 197 (2009) (demonstrating that the more pro-European countries are in Southern Europe while the less pro-European countries are in Scandinavia).

<sup>26</sup> Barry R. Weingast, *The Economic Role of Political Institutions: Market-Preserving Federalism and Economics Growth*, 11 J.L. ECON. & ORG. 1, 14–15 (1995).

<sup>27</sup> Council Regulation 1/2003, On the Implementation of the Rules on Competition Laid Down in Articles 81 and 82 of the Treaty, 2003 O.J. (L 1) 1 (EC). This regulation modernizes E.U. competition policy by delegating to national agencies broad enforcement powers. See Ben Depoorter & Francesco Parisi, *The Modernization of European Antitrust Enforcement: The Economics of Regulatory Competition*, 13 GEO. MASON L. REV. 309, 318 (2005); Marie-Anne Frison-Roche, *A Propos du Règlement Communautaire sur l’application des Articles 81 et 82 du Traité: Variations sur les Lois de Modernisation*, in LA MODERNISATION DU DROIT DE LA CONCURRENCE 31, 31–38 (Guy Canivet ed., 2006).

<sup>28</sup> Jacques Cremer et al., *The Decentralization of Public Services: Lessons from the Theory of the Firm 5* (World Bank Dev. Econ. Policy Research Paper No. 1345, 1994), available at <http://ideas.repec.org/p/wbk/wbrwps/1345.html>.

government would more efficiently carry out some activities, considerations of 'political efficiency' may justify assigning such functions to the states."<sup>29</sup> For instance, in the context of environmental regulation, voter preferences may differ extensively since decisions often require a trade-off between pollution and jobs. Such a controversial political trade-off can be determined only with due attention paid to voters' preferences. Indeed, Cremer et al. argue that "each type of good should be provided by a level of government . . . enjoying a comparative advantage in accounting for the diversity of preferences in its choice of service delivery."<sup>30</sup>

Secondly, decentralization has a disciplinary effect on national regulatory systems. The choice of regulations serves to limit the administrative and bureaucratic costs of the Leviathan. The efficiency gains resulting from the disciplinary effect of regulatory competition become clear when one compares the government to a monopoly for regulations. Centralized standardization can work as a regulatory cartel (or monopoly) intended to regulate the economy to the detriment of consumers (citizens) and thus increase the prices attached to regulations while reducing overall economic efficiency.<sup>31</sup> In contrast, governments subject to fiscal competition realize that the need to provide public goods with minimal taxation and, therefore, the productive efficiency of the government is increased. Indeed, "Pareto efficiency can be raised through fiscal decentralization."<sup>32</sup> Thus, fiscal and regulatory competition may bring about either a "race to the bottom" or a "race to the top," but they always lead to optimization and thus "a race to efficiency."

Competition among legal norms may bring about a sort of Darwinian evolution whereby the most efficient rules survive,<sup>33</sup> hence the alleged greater efficiency of rules promulgated by common law jurisdictions.<sup>34</sup> Ribstein and Kobayashi argue that the efficiency of regulatory competition depends primarily on the prospect of minimizing externalities through regulatory choices in order to compensate for the negative externalities created by deregulated behavior.<sup>35</sup> Evolutionary efficiency (or dynamic efficiency) is commonly cited as the reason for legal transplants and legal

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<sup>29</sup> Larry E. Ribstein & Bruce Kobayashi, *The Economics of Federalism* 5 (Ill. Law & Econ. Working Paper Series, Paper No. LE06-001, 2006), available at [http://www.law.gmu.edu/assets/files/publications/working\\_papers/06-15.pdf](http://www.law.gmu.edu/assets/files/publications/working_papers/06-15.pdf).

<sup>30</sup> Cremer et al., *supra* note 28.

<sup>31</sup> Daniel C. Esty & Damien Gerardin, *Regulatory Co-opetition*, in *REGULATORY COMPETITION AND ECONOMIC INTEGRATION: COMPARATIVE PERSPECTIVES* 30, 33 (Daniel C. Esty & Damien Gerardin eds., 2004).

<sup>32</sup> Ulrich Thießen, *Fiscal Federalism in Western European and Selected other Countries: Centralization or Decentralization? What is Better for Economic Growth?* 5 (Deutsches Institut für Wirtschaftsforschung, Paper No. 224, 2000), available at <http://www.econstor.eu/bitstream/10419/18209/1/dp224.pdf>.

<sup>33</sup> TODD J. ZYWICKI, *THE RISE AND FALL OF EFFICIENCY IN THE COMMON LAW: A SUPPLY-SIDE ANALYSIS* (2003), reprinted in *THE EVOLUTION OF EFFICIENT COMMON LAW*, 643-44 (Paul H. Rubin & Samuel Candler Dobbs eds., 2007) ("the market for law created by the polycentric nature of the historic common law gave rise to a pro-efficiency dynamic of market competition . . . At the same time, this non-hierarchical and decentralized institutional structure insulated the common law from rent-seeking pressures and constrained judges.")

<sup>34</sup> See George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65, 81 (1977).

<sup>35</sup> Ribstein & Kobayashi, *supra* note 29, at 4.

formants in the literature of comparative law and economics.<sup>36</sup> In this respect, regulatory competition is said to boost overall efficiency because the most efficient legal rules will prevail and will be disseminated through legal transplants and legal formants.<sup>37</sup> Economic welfare increases when the provision of goods and services by local governments takes the local preferences of voters into full account and therefore does not suffer from horizontal compromises in which voter preferences are not entirely satisfied.<sup>38</sup> In other words, if decision-making is centralized with regard to policies about which voters have heterogeneous preferences, the result is sub-optimal as compared to decentralized decision making, since this latter option allows for the maximization of voters' utility through their revealed local preferences.<sup>39</sup>

Ultimately, decentralization renders an innovative and experimental policy-making strategy possible. Decentralization enables economic agents to discover the regulation best suited to their needs in both formal and substantial terms.<sup>40</sup> Asymmetrical access to information among policy-makers and economic agents is compensated for by regulatory competition, which produces informational cost reductions through an *ex ante* phase of discovery of and experimentation among different policies. Levels of governance work as laboratories, according to Oates, thus allowing for the testing of different policy measures at each level.<sup>41</sup> After this exploratory phase, regulatory competition may fuel innovation through information acquired regarding the alternative options available for pertinent regulations. Thus, a real "market for regulations" grants governments access to previously hidden information regarding potential alternative regulations (informational cost reduction), and in return, this information allows for optimally diverse local regulations (regulatory efficiency), according to Hayekian reasoning.

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<sup>36</sup> Ugo Mattei, *Efficiency in Legal Transplants: An Essay in Comparative Law and Economics*, 14 INT'L REV. L. & ECON. 3 (1994); Anthony Ogus, *Competition Between National Legal Systems: A Contribution of Economic Analysis to Comparative Law*, 48 INT'L & COMP. L.Q. 405 (1999); Jan M. Smits, *How to Predict the Differences in Uniformity Between Different Areas of a Future European Private Law? An Evolutionary Approach*, in ECONOMICS OF HARMONIZING EUROPEAN LAW 50, 50–70 (2002).

<sup>37</sup> See Ugo Mattei, *supra* note 36, for sources of law.

<sup>38</sup> See Alberto F. Alesina et al., *International Unions*, 95 AM. ECON. REV. 602, 602 (2005) (arguing that the costs of centralization are those related to sacrificing the heterogeneous preferences of local governments). The economies of scale reaped by further centralization must therefore be weighed against the costs of ignoring these heterogeneous preferences. Consequently, striking the right balance between subsidiarity and the economies of scale derived from centralization can bring about optimal multi-tier governance.

<sup>39</sup> Fritz Breuss & Markus Eller, *The Optimal Decentralisation of Government Activity: Normative Recommendations for the European Constitution*, 15 CONST. POL. ECON. 27, 30 (2004).

<sup>40</sup> See Martti Vihanto, *Competition Between Local Governments as a Discovery Procedure*, 148 J. INST. THEORETICAL ECON. 411, 415 (1992); see also Francesco Parisi & Larry E. Ribstein, *Choice of Law*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 236 (Peter Newman ed., 1998).

<sup>41</sup> Wallace E. Oates, *An Essay on Fiscal Federalism*, 37 J. ECON. LIT. 1120, 1131–33 (1999). See also *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) (arguing that "[i]t is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.").



As a consequence, various economic insights, such as the heterogeneity of preferences and the efficiency of the competitive process for government regulation, may lead to the conclusion that decentralization guarantees efficiency gains.<sup>42</sup> Despite the efficiency gains possibly reaped from the further decentralization of decision-making—and, hence, from the principle of subsidiarity in the E.U.—one should not disregard the parallel efficiency gains that centralization can bring about. For that reason, the overall efficiency of a multi-level governance structure can only be properly evaluated through an inquiry into the economics of centralization. Thus, this article shall now examine the efficiency gains derived from centralization.

## 2. Economics of Centralization

The economic *raison d'être* behind centralization lies in the efficiency of harmonizing legal norms and standards. The enactment of a harmonized legal rule facilitates economies of scale, which allow for further efficiency gains.<sup>43</sup> These efficiency gains materialize through the presence of internalized horizontal externalities and increasing returns of legal production.<sup>44</sup>

The economic approach to federalism is usually attributed to Tiebout, who argues that inter-jurisdictional competition better provides for public goods when there is full mobility of both factor inputs and persons across territories.<sup>45</sup> In Tiebout's model, public goods are produced and allocated efficiently between the different levels of governance if and only if (i) factor inputs and persons are fully mobile, (ii) the number of local governments is sufficiently numerous, (iii) each local government has free choice among legal norms to implement, and (iv) there are

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<sup>42</sup> Ultimately, the efficiency gains from decentralization may lead to a political disintegration of the States. When combined with economic integration of governments, the decentralization process allows for economic benefits to be maximized while the political benefits of belonging to a particular State shrink drastically. This sort of paradox of economic integration is shown by Michele Ruta, who promotes the idea that European economic integration between Member States may explain the political separatism experienced within those States in recent years. Michele Ruta, *Economic Theories of Political (Dis)Integration*, 19 J. ECON. SURVEYS 1, 17 (2005).

<sup>43</sup> See Reiner Eichenberger & Gerald Hosp, *Die Institutionellen Leitplanken Wirkungsvollen Föderalismus, Erfahrungen Aus Der Schweiz*, in *ÖKONOMISCHE ASPEKTE DES FÖDERALISMUS* 87, 87–104 (Peter Pernthaler & Peter Bußjäger eds., 2001); see also Jenna Bednar et al., *The Politics of European Federalism*, 16 INT'L REV. L. & ECON. 279, 282 (1996) (stating that “membership in federations is costly; members hope to increase their security or rates of economic growth, but they pay for these benefits by ceding some authority to the central government.”).

<sup>44</sup> See Dominique Bureau & Paul Champsaur, *Fiscal Federalism and European Economic Unification*, AM. ECON. REV., May 1992, at 88, 89 (“budgetary intervention at the Community level ought to be admitted only in the presence of cross-border externalities or economies of scale, which cannot be properly alleviated by a simple coordination between concerned national governments.”).

<sup>45</sup> Tiebout, *supra* note 20. For a general discussion on inter-jurisdictional competition, see Wolfgang Kerber, *Interjurisdictional Competition Within the European Union*, 23 FORDHAM INT'L L.J. 217, 249 (2000), stating that the “basic problem is not whether we want interjurisdictional competition, but the conclusion is that if we want simultaneous mobility and decentralization, then we must accept interjurisdictional competition and we must think about ways to make competition process workable.” Kerber further argues that “[t]he concept of interjurisdictional competition suggests that, within an appropriate framework of rules, competition processes might not only be workable, but also might even lead to more desirable outcomes regarding the innovative improvement of the provision of public goods and services, and their efficient production, than traditional monopoly states.” *Id.*

neither spill-overs nor interfering externalities.<sup>46</sup> Nevertheless, these assumptions are so strong that one can legitimately argue that it is precisely because these assumptions are not realistic that regulatory and fiscal competition is flawed. Thus, more realistic conditions may justify further centralization.

Furthermore, centralization may increase the probability of capture from rent-seeking activities.<sup>47</sup> Indeed, having fewer regulators puts greater pressure on the centralized regulator: rent-seekers can center their efforts on only one decision-maker and expect to reap the benefits of influencing the entire centralized jurisdiction. Nevertheless, the same danger exists regarding the increased ease of capturing decentralized regulators since each one essentially possesses a (quasi) monopoly over the promulgation of law in a given jurisdiction.<sup>48</sup> Decentralized decision-makers may be subject to capture to a greater extent because potential reputational costs are lower: fewer people may know about the capture, and if it does become known, it may be justified on economic protectionism grounds.<sup>49</sup>

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<sup>46</sup> WALLACE E. OATES, *FISCAL FEDERALISM* (1972).

<sup>47</sup> Rent-seeking refers to the fact that private interest groups gain economic rents at the expense of social welfare because of the protection of less-efficient economic agents through political influence. The literature on welfare losses due to rent-seeking spans decades. See Roger D. Congleton et al., *40 Years of Research on Rent Seeking: An Overview*, in *140 YEARS OF RESEARCH ON RENT SEEKING: THEORY OF RENT SEEKING* (Roger D. Congleton et al. eds., 2008). The foundational article is Gordon Tullock, *The Welfare Costs of Tariffs, Monopolies, and Theft*, 5 *ECON. INQUIRY* 224, 230 (1967) (“Transfers themselves cost society nothing, but for the people engaging in them they are just like any other activity, and this means large resources may be invested in attempting to make or prevent transfers. These largely offsetting commitments of resources are totally wasted from the standpoint of society as a whole.”).

<sup>48</sup> Anthony Ogus, *The Economic Basis of Legal Culture: Networks and Monopolization*, 22 *O.J.L.S.* 419, 419 (2002).

<sup>49</sup> Faure and Johnston describe what they call a paradox in federal environmental law in the sense that local issues (such as waste) are federalized even though they create no interjurisdictional externalities. Michael G. Faure & Jason Scott Johnston, *The Law and Economics of Environmental Federalism: Europe and the United States Compared 2* (U. Pa. Inst. for L. & Econ., Paper No. 08–07, 2008), available at <http://ssrn.com/abstract=1098493>. However, it is possible to understand these laws and judicial decisions from an efficiency viewpoint. The Supreme Court and the ECJ seem to have been willing to promote the rise of a market for waste so that allocative efficiency is increased throughout the U.S. and the E.U. respectively. This reasoning is in line with what Weingast calls “market-preserving federalism.” Barry R. Weingast, *The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development*, 11 *J.L. ECON. & ORG.* 1, 4 (1995). Moreover, it is nonetheless true that private interest groups are able to seek greater centralization so that rent-seeking is eased. Thus, environmental interest groups in the U.S. have successfully ushered through numerous bills in few years, something that could not have been achieved so quickly and so widely had decentralization prevailed. For instance, Congress adopted the National Environmental Policy Act in 1970, Clean Air Amendments in 1970, Federal Water Pollution Control Act Amendments in 1972, Federal Environmental Pesticide Control Act in 1972, Marine Mammal Protection Act in 1972, Noise Control Act in 1972, Coastal Zone Management Act in 1972, and the Endangered Species Act in 1973. National Environmental Policy Act of 1969, Pub. L. No. 91-190, 83 Stat. 852 (1970); Clean Air Amendments of 1970, Pub. L. No. 91-604, 84 Stat. 1676 (1970); Federal Water Pollution Control Act Amendments of 1972, Pub. L. No. 92-500, 86 Stat. 816 (1972); Federal Environmental Pesticide Control Act of 1972, Pub. L. No. 92-516, 86 Stat. 973 (1972); Marine Mammal Protection Act of 1972, Pub. L. No. 92-522, 86 Stat. 1027 (1972); Noise Control Act of 1972, Pub. L. No. 92-574, 86 Stat. 1234 (1972); Coastal Zone Management Act of 1972, Pub. L. No. 92-583, 86 Stat. 1280 (1972); Endangered Species Act of 1973, Pub. L. No. 93-205, 87 Stat. 884 (1973).

Cooperative federalism says that centralization is efficient if and only if the centralizing process is approved unanimously by all decentralized entities. However, because of the very high costs of Coasean bargaining<sup>50</sup> for local governments, the internalization of externalities is unreachable through bargaining and Pareto optimality cannot be achieved.<sup>51</sup> Yet, Pareto efficiency is very restrictive<sup>52</sup> and so a looser notion of economic efficiency derived from the Kaldor-Hicks criterion of efficiency should be adopted in order to overcome the practical complexity of reaching an inter-jurisdictional agreement. In fact, Kaldor-Hicks efficiency only requires that a majority gain sufficiently from a legal change so that those who lose out as a result of that change may be compensated, thereby leaving everybody better off. Thus, society can enjoy the various benefits of centralized regulation.

Most importantly, when decision-makers' or voters' preferences are (at least quasi) homogeneous, they overlap and allow for centrally adopted compromises in regulation, which maximize the utility of each jurisdiction. The assumption that local governments play non-cooperative games supports this intuition. Local governments can thus voluntarily increase informational costs (e.g. those necessary for revealing voters' preferences) or monitoring costs (e.g. if, due to weak institutionalization of local governments, moral hazard renders it possible for some local government to hide their (in)actions). When seeking to avoid strategic, non-cooperative behavior among local governments, harmonization becomes the most efficient answer. Legal harmonization may be justified because, when a government changes its law in order to comply with foreign legal norms, only this government bears the costs of switching. Yet, both the government exporting the legal norm and the one integrating the norm gain from the economies of scale and the transactional cost reductions that result from increased legal harmonization. Each government, therefore, prefers harmonization through the exportation of its own legal norm to harmonization through the importation of new norms precisely because of the substantial and unilateral costs incurred by the switching party. Garoupa and Ogus conclude that, given a model in which two governments exchange goods and services, but only one shifts its norms while both benefit from the change, a central authority is the only solution to issues of coordination.<sup>53</sup> Governments would thus entrust this central authority with harmonizing powers. Mutualization of the switching costs makes it possible to avoid free-riding. Significantly, this centralization always reduces the costs incurred by actors' strategic behavior to a greater extent than it reduces the benefits expected from the maximization of local

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<sup>50</sup> See R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15 (1960). See generally Robert Cooter, *The Cost of Coase*, 11 J. LEGAL STUD. 1 (1982); Tore Ellingsen, *Externalities vs. Internalities: A Model of Political Integration*, 68 J. PUB. ECON. 251 (1998).

<sup>51</sup> Robert Ellickson, *Public Property Rights: Vicarious Intergovernmental Rights and Liabilities as a Technique for Correcting Intergovernmental Spillovers*, in *ESSAYS ON THE LAW AND ECONOMICS OF LOCAL GOVERNMENTS* 53 (Daniel Rubinfeld ed., 1979); Donald Wittman, *Why Democracies Produce Efficient Results*, 97 J. POL. ECON. 1395, 1399 (1989).

<sup>52</sup> See Cooter, *supra* note 50, at 1.

<sup>53</sup> Nuno Garoupa & Anthony Ogus, *A Strategic Interpretation of Legal Transplants*, 35 J. LEGAL STUD. 339, 339 (2006).

preferences. Thus, the institutionalization of local government behavior through harmonization becomes the optimal response.<sup>54</sup>

In addition, regulatory competition incurs some costs for local governments. Specifically, the fact that inter-jurisdictional competition increases economic efficiency implies (in models such as those proposed by Farber<sup>55</sup> and Revesz<sup>56</sup>) that there are homogeneous preferences in local governments and perfect competition so that monopolistic profits and economic rents are absent. In reality, inter-jurisdictional competition often leads to sub-optimal outcomes. With respect to environmental regulation, for example, inter-jurisdiction competition produces a situation in which local governments' incentives to attract mobile inputs such as capitals and qualified workers result in sub-optimal level of environmental protection. This sub-par state of affairs results from the fact that the inter-jurisdictional competition is not equivalent to market competition: local governments can hardly bargain over the externalities in a Coasean fashion.<sup>57</sup> And, even if Coasean bargaining between jurisdictions were possible, the cost of transacting and the amount of resources allocated for this bargaining would decrease the overall wealth of the government.<sup>58</sup> These un-negotiated externalities impose social costs that may render everyone except the polluting jurisdiction worse off.<sup>59</sup> A race to the bottom between local governments' regulatory systems may be one of the detrimental effects of over-deregulation.<sup>60</sup> As a result, social costs would noticeably increase in the long term because of the so-called "tragedy of the commons," given that the market cannot efficiently supply environmental protection regulations. Hence, local governments would abrogate economically rational regulations in order to keep afloat in light of the strained competition between local governments.<sup>61</sup>

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<sup>54</sup> *Id.*

<sup>55</sup> Daniel A. Farber, *State Regulation and the Dormant Commerce Clause*, 3 CONST. COMMENT. 395, 396 (1986).

<sup>56</sup> Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race-to-the-bottom" Rationale for Federal Environmental Regulation*, 67 N.Y.U. L. REV. 1210, 1211-12 (1992).

<sup>57</sup> See generally Coase, *supra* note 50, at 1; Cooter, *supra* note 50; Ellingsen, *supra* note 50.

<sup>58</sup> Mancur Olson, Jr., *The Principle of "Fiscal Equivalence": The Division of Responsibilities among Different Levels of Government*, AM. ECON. REV. PAPERS & PROC., May 1969, at 481; Robert P. Inman & Daniel L. Rubinfeld, *The Political Economy of Federalism*, in PERSPECTIVES ON PUBLIC CHOICE: A HANDBOOK 73, 78-79 (Dennis C. Mueller ed., 1997). Scharpf affirms, "As the number of affected parties increases . . . negotiated solutions incur exponentially rising and eventually prohibitive transaction costs." FRITZ WILHELM SCHARPF, GAMES REAL ACTORS PLAY: ACTOR-CENTERED INSTITUTIONALISM IN POLICY RESEARCH 70 (1997).

<sup>59</sup> SUSAN ROSE-ACKERMAN, RETHINKING THE PROGRESSIVE AGENDA: THE REFORM OF THE AMERICAN REGULATORY STATE 166-70 (1992); Kirsten H. Engel, *State Environmental Standard-Setting: Is There a "Race" and Is It "To the Bottom"?*, 48 HASTINGS L.J. 271, 302-05 (1997); James R. Markusen, Edward R. Morey & Nancy Olewiler, *Competition in Regional Environmental Policies When Plant Locations Are Endogenous*, 56 J. PUB. ECON. 55, 55 (1995); Revesz, *supra* note 56, at 1223.

<sup>60</sup> Justice Brandeis discusses the consequences of regulatory competition in *Liggett Co. v. Lee*, 288 U.S. 517, 558-59 (1933). It is interesting to note that Justice Brandeis in his opinion uses "race to the bottom" and "race to efficiency" interchangeably. Esty and Gerardin sum up this idea as: "To the extent that there is a race, it generates welfare gains." Esty & Gerardin, *supra* note 31, at 30. Cary conceptualized the expression in the field of corporate law. William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 Y. L. J. 663, 666 (1974).

<sup>61</sup> Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387, 387-89 (1954).

Furthermore, regulatory competition is innately related to fiscal competition, leading to regressive taxation for mobile input factors, which need to be attracted to the jurisdiction, but diminishing redistributive policies for poorer and less mobile persons who play only a minimal role in the regulatory market.<sup>62</sup> Fiscal competition can also bring about an inefficient outcome due to an under-provision of public goods.<sup>63</sup> Hence, capital is insufficiently taxed compared to labor, and the sub-optimal allocation of resources in local public goods leads them to become underprovided.<sup>64</sup> Externalities and spillovers, which are critically present in a decentralized economy, might be mitigated through taxation.<sup>65</sup>

Lastly, opposite this risk of under-regulation, paradoxically, there is also a risk of overregulation due to the willingness of some local decision-makers to adopt protectionist policies. These policies may result from a desire to block or render the entry of cheaper or better quality goods or persons into the local market more difficult in order to artificially shelter local goods and persons from external competition.<sup>66</sup> The argument that the tendency for local governments to amplify switching costs is equivalent to a “race to the top” is weak given that the attraction for economic protectionism remains large. Sub-optimal overregulation leaves local government disposed to the protection of local firms and workers at the expense of more efficient foreign ones. In addition, a local government may choose to increase the switching costs for individuals and firms to invest and settle in its jurisdiction rather than lower those costs so that they economically protect their local resources at the expense of allocative efficiency.<sup>67</sup> Efficiency gains are reaped from the internalization of the inter-jurisdictional spillovers.<sup>68</sup> True, externalities of local regulations can be either positive (and bring about sub-optimal under-regulation) or negative (and bring about sub-optimal overregulation): in both cases, the presence of prohibitively high costs for Coasean bargaining requires regulatory measures to internalize the externalities.

Consequently, centralization reinforces the functioning of markets and, as a result, increases economic efficiency and economic growth.<sup>69</sup> Society allows for

<sup>62</sup> Dennis Epple & Thomas Romer, *Mobility and Redistribution*, 99 J. POL. ECON. 828, 828 (1991).

<sup>63</sup> WALLACE E. OATES, *FISCAL FEDERALISM* 142–43 (1972).

<sup>64</sup> Timothy J. Goodspeed, *Tax Competition and Tax Structure in Open Federal Economies: Evidence from OECD Countries with Implications for the European Union* (Centre for Eur. Econ. Res., 1999), available at <http://madoc.bib.uni-mannheim.de/madoc/volltexte/2004/605/pdf/dp9939.pdf>; Richard Baldwin & Paul Krugman, *Agglomeration, Integration, and Tax Harmonization* 3 (Centre for Econ. Pol'y Res., Paper No. 2630, 2000).

<sup>65</sup> Russell Krelove, *Efficient Tax Exporting*, 25 CAN. J. ECON. 145, 145 (1992).

<sup>66</sup> Jeanne-May Sun & Jacques Pelkmans, *Regulatory Competition in the Single Market*, 33 J. COMMON MKT. STUD. 67, 85 (1995).

<sup>67</sup> Emanuela Carbonara & Francesco Parisi, *The Paradox of Legal Harmonization*, 132 PUB. CHOICE 367, 369–70 (2007).

<sup>68</sup> Gisela Färber, *Effizienz zentralisierter und dezentralisierter Verwaltungen*, in *ÖKONOMISCHE ASPEKTE DES FÖDERALISMUS* 105, 110 (Peter Perenthaler & Peter Bussjäger eds., 2001).

<sup>69</sup> Weingast has elaborated “market-preserving federalism.” Barry R. Weingast, *The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development*, 11 J.L. ECON. & ORG. 1, 1 (1995); see also Yingyi Qian & Barry R. Weingast, *Federalism as a Commitment to*

limited governments because of the efficiency gains produced by both centralization and decentralization. Decentralized levels of governance should have priority when regulations are to be adopted, despite the fact that a central level of governance generates benefits in terms of limiting the potential free-riding by local governments.<sup>70</sup> Indeed, the efficiency gains and losses attached to both centralization and decentralization render the normative power of the efficiency of the subsidiarity principle rather delicate. Without doubt, however, multi-level governance is the most optimal solution.<sup>71</sup> This is precisely the approach—that is, ensuring the capture of efficiency gains when designing policies in line with the subsidiarity principle—that has been codified in European Treaties.

### B. Efficiency of the Subsidiarity Principle in E.U. Primary Law

Preliminarily, Article 5(3) TEU states:

Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at the central level or at regional and local level, but can rather, by reason of scale or effects of the proposed action, be better achieved at the Union level.<sup>72</sup>

From this, we can infer that Article 5(3) encapsulates a double test for the enforcement of the principle of subsidiarity, allowing the E.U. to act when it has the power to do so. It is presumed that Member States have priority to take action in the domains of shared competences unless this presumption is rebutted by passing the double test. This double test encompasses, as its first prong, a sufficiency test permitting the E.U. to act “only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by Member States.”<sup>73</sup> As its second prong, there is a value-added test: the E.U.’s action “by reason of the scale or effects of the proposed action [can] be better achieved at the Union level.”<sup>74</sup> Both tests are cumulative,<sup>75</sup> and the sufficiency test is the sine qua non condition to the value-added test.

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*Preserving Market Incentives*, J. ECON. PERSP., Fall 1997, at 83; Jonathan Rodden & Susan Rose-Ackerman, *Does Federalism Preserve Markets?*, 83 VA. L. REV. 1521, 1521 (1997).

<sup>70</sup> A closely related notion is what Esty and Gérardin call “co-opetition.” Esty & Gerardin, *supra* note 31, at 30.

<sup>71</sup> See *infra* Annex 1.

<sup>72</sup> TEU art. 5(3).

<sup>73</sup> *Id.*

<sup>74</sup> ANTONIO ESTELLA, *THE EU PRINCIPLE OF SUBSIDIARITY AND ITS CRITIQUE* 93 (2005).

<sup>75</sup> Article 5 of the Protocol on Subsidiarity as proclaimed in the Amsterdam Treaty says:

For Community action to be justified, both aspects of the subsidiarity principle shall be met: the objectives of the proposed action cannot be sufficiently achieved by Member States’ action in the framework of their national constitutional system and can therefore be better achieved by action on the part of the Community.

Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, art 5., Oct. 2, 1997 O.J. (C 340) 1.

The sufficiency test is tantamount to an effectiveness test: the E.U. intervenes if and only if the actions of Member States are either ineffective or nonexistent despite the need for action. The E.U. is then entitled to act only if such action is in response to the ineffectiveness of Member States' actions and if the E.U. guarantees the effectiveness of its own action. An ineffective action on the part of the Member States cannot be replaced by an ineffective E.U. action—decentralization will always be preferred. The rationale behind this double criterion is the guarantee of effectiveness inherent in the sufficiency test.

In addition, the value-added test is tantamount to an efficiency test: the E.U. intervenes if and only if it can deliver net benefits superior to what Member States' actions would convey. These net benefits can be greater either due to the ineffectiveness of the Member States' actions or the inefficiency of Member States' actions as compared to those potentially taken by the E.U.. Comparative efficiency is thus tested by weighing, on the one hand, the costs and benefits of Member States' actions, and, on the other hand, the costs and benefits of potential E.U. actions.<sup>76</sup> The level of governance maximizing the net benefits is the most appropriate level of legal intervention, which will pass the general test of compliance with the principle of subsidiarity. Consequently, one can say that the principle of subsidiarity as proclaimed by the European Treaties' double test has an intrinsic economic rationale.<sup>77</sup> By meticulously applying this double test to determine the appropriate level of governance, the principle of subsidiarity encompasses the very notion of economic efficiency and thus contributes to the promotion of the overall economic efficiency through its application.<sup>78</sup>

Accordingly, and contrary to the criticism arguing that it would block institutional competition,<sup>79</sup> Article 5(3) TEU, and more generally the principle of subsidiarity, allows for an efficiency analysis comparing regulatory competition through decentralization and legal harmonization through standardization. In order to implement the principle of subsidiarity, one must assess whether or not the given

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<sup>76</sup> Lenaerts explained that the subsidiarity test of the old Article 130r(4) prescribes “a comparative enquiry into the efficiency of the community and the individual Member States in attaining the objectives of European environmental policy[.]” Koen Lenaerts, *The Principle of Subsidiarity and the Environment in the European Union: Keeping the Balance of Federalism*, 17 *FORDHAM INT'L L. J.*, 846, 859 (1994). More generally, this test is essentially equivalent to a comparative institutional approach whereby the costs of market failure are weighed against the cost of centralization. Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 *J.L. & ECON.* 1, 1 (1969); see also Frans Pennings, *Is the Subsidiarity Principle Useful to Guide the European Integration Process?*, 2 *TILBURG FOREIGN L. REV.* 153, 160 (1993).

<sup>77</sup> Burrows thinks that “although the protagonists of constitutional change couch their arguments mainly in the political language, economic issues have an immense underlying importance in determining the choice among different constitutional structures.” SIR BERNARD BURROWS, *DEVOLUTION OR FEDERALISM: OPTIONS FOR A UNITED KINGDOM* 45 (1980).

<sup>78</sup> Clearly, Pelkmans affirms: “the efficiency function of the EU is by far the most important one for the application of the subsidiarity principle.” Jacques Pelkmans, *Subsidiarity Between Law and Economics* 43 (College of Europe Eur. Legal Stud. Dep't, Paper No. 1/2005, 2005), available at [http://www.coleurop.be/file/content/studyprogrammes/law/studyprog/pdf/ResearchPaper\\_1\\_2005\\_Pelkmans.pdf](http://www.coleurop.be/file/content/studyprogrammes/law/studyprog/pdf/ResearchPaper_1_2005_Pelkmans.pdf).

<sup>79</sup> Christian Kirchner, *Competence Catalogues and the Principle of Subsidiarity in a European Constitution*, 8 *CONST. POL. ECON.* 71, 80 (1997).

legal act passes the efficiency test enshrined in Article 5(3) TEU. The proscriptive dimension of the principle of subsidiarity, or negative subsidiarity, tells us that the central authority may not intervene if such intervention would not be comparatively more efficient than intervention at a more local level of governance. Additionally, another conception of this principle of subsidiarity, or positive subsidiarity, says that the central authority is required to intervene when it is comparatively more efficient to do so.<sup>80</sup>

Understanding the subsidiarity principle as an economic principle allows lawyers and policymakers to have clearer guidelines for transforming the abstract concept into practical terms.<sup>81</sup> The subsidiarity principle is not an ordinary political principle; it is an efficiency principle that is interpreted as such by the European Court of Justice (ECJ).<sup>82</sup>

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<sup>80</sup> For a discussion on the negative and positive sides of subsidiarity, see Ken Endo, *The Principle of Subsidiarity: From Johannes Althusius to Jacques Delors*, 44 HOKKAIDO L. REV. 2064, 2064 (1994). See also Renaud Dehousse, *From Community to Union, in EUROPE AFTER MAASTRICHT: AN EVER CLOSER UNION?* 5, 10 (Renaud Dehousse ed., 1994).

<sup>81</sup> Oostlander says that the efficiency rationale underlying the subsidiarity principle must not be the only rationale for the principle: a moral justification prevails over the efficiency justification. Indeed, Oostlander argues that:

[T]he first mistake being made concerns the neglect of the moral contents of the concept. Many think that subsidiarity is only about the allocation of competence according to the criterion of efficiency . . . Accepting the touchstone of efficiency only conceals the moral issue. For efficiency itself should have a purpose . . . Political practice insufficiently acknowledges that subsidiarity is intimately linked with social personalism.

Arie Oostlander, *Horizontale Subsidiariteit* [Horizontal Subsidiarity], 12 CHRISTEN DEMOCRATISCHE VERKENNINGEN (Neth.) 367, 373 (1992), translated in Kees Van Kersbergen & Bertjan Verbeek, *The Politics of Subsidiarity in the European Union*, 32 J. COMMON MKT. STUD. 215, 224 (1994). Oostlander advocates the common interpretation of the subsidiarity principle that is in line with the Catholic social and political doctrine of the State. To add a moral dimension to the subsidiarity principle is unhelpful for the purpose of understanding the ECJ rulings in the field, as the ECJ does not refer at all to any morality in the subsidiarity principle. Moreover, this moralistic approach undermines the importance of the efficiency rationale of the subsidiarity principle (both the principle and the ECJ follow-up jurisprudence), which was accepted by all Member States.

<sup>82</sup> It is important to explain here that defining the principle of subsidiarity neither as a legal principle nor as a political principle but merely as an economic principle encompassing the idea of economic efficiency should not induce the reader to conclude that the principle of subsidiarity can easily be defined with respect to its effects. Indeed, the contrary has been shown in this section—the subsidiarity principle has ambivalent effects (entailing as much efficiency gains as efficiency losses). Therefore, understanding the subsidiarity principle allows one to understand its social consequences without automatically providing an abstract definition of this principle that can only be defined casuistically—hence the following section on the interpretation of this principle by the ECJ. Therefore, I agree with Blichner and Sangolt when they say that attempts to define the subsidiarity principle which include “goals, choice of the best alternative and . . . the expected effect of alternative actions” might be counter-productive. See Lars C. Blichner & Linda Sangolt, *The Concept of Subsidiarity and the Debate on European Cooperation: Pitfalls and Possibilities*, 7 GOVERNANCE: AN INT’L J. POL’Y & ADMIN. 284, 291 (1994). Thus,

[a] serious effort to construct a clear and unambiguous definition of subsidiarity will tend to undermine constructive debate whether the effort fails or not. If it fails, the likely conclusion would be that the concept is too ambiguous and impossible to



## II. THE PRINCIPLE OF SUBSIDIARITY AS A PRINCIPLE OF ECONOMIC EFFICIENCY IN ECJ JURISPRUDENCE

The article shall here outline the jurisprudence on the principle of subsidiarity as elaborated upon by the Court. As this jurisprudence reveals, the Court interprets the principle of subsidiarity very timidly and adopts a position of judicial self-restraint. From the following analysis of ECJ caselaw on the principle of subsidiarity, the article will conclude that only the procedural side of the principle of subsidiarity is judicially reviewed (Part II.A). The jurisprudential approach shall be analyzed from the viewpoint of efficiency, as the closing discussion of this section concerns the substantive side of the subsidiarity principle, which is left to the discretion of the E.U. legislator (Part II.B).

### A. *The Efficiency of Judicial Review on Procedural Subsidiarity*

The principle of subsidiarity essentially functions as a legal means for a second judicial review by the ECJ—the first review being for the compliance of E.U. legal acts with the principle of conferred powers.<sup>83</sup> The judicial review of the subsidiarity principle does not come without some skepticism due to the inherently political implications of the principle of subsidiarity. The justiciability of the principle before the Court has, therefore, been legitimately questioned.<sup>84</sup> We assume that this uncertainty is, for the most part, owed to the economic rationale essential to the principle of subsidiarity. As previously mentioned, the literature generally sees the principle as a sheer political message from the Member States to the supranational institutions of the E.U.<sup>85</sup> In this respect, the principle of subsidiarity may legitimately be seen as an illustration of the liberal intergovernmentalism doctrine of Moravcsik, whereby Member States appear to be strengthened through the implementation of the principle of subsidiarity.<sup>86</sup> Hence, the liberal

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use. If successful, the matter would then be left to an established authority, like the courts, to decide. This would limit debate and seems counteractive to the very idea inherent in the principle of subsidiarity.

*Id.* at 292.

<sup>83</sup> TEU art. 5.

<sup>84</sup> See, e.g., George A. Bermann, *Taking Subsidiarity Seriously: Federalism in the European Community and the United States*, 94 COLUM. L. REV. 331, 336 (1994); Daniel G. Partan, *The Justiciability of Subsidiarity*, in BUILDING A EUROPEAN POLITY? 63, 64–65, 76 (Carolyn Rhodes & Sonia Mazey eds., 1995); Akos Toth, *Is Subsidiarity Justiciable?*, 19 EUR. L. REV. 268, 270–71 (1994). Swaine argues that judicial subsidiarity attenuates the effects and the scope of the state liability doctrine designed by the Court itself. Edward T. Swaine, *Subsidiarity and Self-Interest: Federalism at the European Court of Justice*, 41 HARV. INT'L L. J. 1, 8 (2000). Article 8 of the Protocol No. 2 of the Lisbon Treaty states: “the Court of Justice of the European Union shall have jurisdiction in actions on grounds of infringement of the principle of subsidiarity by a legislative act[.]” Subsidiarity Protocol, *supra* note 7, art. 8. The European Parliament is favorable to the judicial review of the principle of subsidiarity. See European Parliament Committee on Institutional Affairs, Report on the Principle of Subsidiarity, EUR. PARL. DOC. A3–267/90 (1990).

<sup>85</sup> Renaud Dehousse, *Institutional Reform in the European Community: Are There Alternatives to the Majoritarian Avenue?* (Eur. Univ. Inst., Working Paper RSC 95/4).

<sup>86</sup> Andrew Moravcsik, *Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach*, 31 J. COMMON MKT. STUD. 473, 507 (1993) [hereinafter Moravcsik,

intergovernmentalist configuration of the E.U. would seem to reinforce the power of Member States.<sup>87</sup> Nevertheless, the principle of subsidiarity had to come before the ECJ given that the European Treaties enshrine the principle as a general principle of E.U. law. In a way, the ECJ has divided the subsidiarity principle into two dimensions—a procedural one and a substantive one—with the former receiving more judicial scrutiny than the latter.

The earliest case in which the principle of subsidiarity was invoked before the European Courts was the *SPO* case,<sup>88</sup> where the General Court legitimately refused to establish the legality of the principle of subsidiarity before the Maastricht Treaty entered into force.<sup>89</sup>

The ECJ recognized this in the *Buralux* case, where it held that the principle of subsidiarity does not diminish the jurisdiction of Member States when dealing with their own powers.<sup>90</sup> Thus, the ECJ rejected the argument that a Member State used an overly broad margin of appreciation when elaborating a national policy. Given this case, the principle of subsidiarity may merely set a boundary for the margin of appreciation that the European institutions enjoy in their actions, not a margin of appreciation for Member State actions.<sup>91</sup> However, the ECJ has also held that Member States are not exempt from their obligation not to restrain the transmission of broadcasting in the E.U. on the grounds of the principle of subsidiarity.<sup>92</sup>

In *Germany v. European Parliament and Council*,<sup>93</sup> the ECJ correctly judged that precisely because of the Court's inability to undertake the test of comparative efficiency, the ECJ's review is limited to the reasoning given as justification for the E.U. legal act with respect to subsidiarity by the E.U. legislator. In this case, according to Germany, a directive did not sufficiently justify the legal need for its existence.<sup>94</sup> The principle of subsidiarity is thus here understood from a procedural viewpoint only.<sup>95</sup> It is certainly required that "the measures concerned should

*Preferences and Power*]. Note, however, that this article has been superseded by his book *Choice for Europe*. ANDREW MORAVCSIK, *THE CHOICE FOR EUROPE: SOCIAL PURPOSE AND STATE POWER FROM MESSINA TO MAASTRICHT* (1998).

<sup>87</sup> "In the intergovernmentalist view, [t]he unique institutional structure of the [E.U.] is acceptable to national governments only insofar as it strengthens, rather than weakens, their control over domestic affairs . . . ." Moravcsik, *Preferences and Power*, *supra* note 86, at 507.

<sup>88</sup> Case T-29/92, *Vereniging van Samenwerkende Prijsregelnde Organisaties in de Bouwnijverheid v. Comm'n*, 1995 E.C.R. II-289.

<sup>89</sup> *Id.* ¶ 331.

<sup>90</sup> Case C-209/94 P, *Buralux SA v. Council*, 1996 E.C.R. I-615.

<sup>91</sup> The firm *Buralux SA* had brought waste from Germany to France illegally in violation of a French decree. The plaintiffs argued that, according to the principle of subsidiarity, France should not have enjoyed such wide margin of appreciation for the adoption of the decree. This argument was rejected by the ECJ, which followed the Advocate General's recommendation for a narrow interpretation of the principle of subsidiarity. See *Buralux*, 1996 E.C.R. I-615; Opinion of Advocate General Lenz, Case C-209/94, *Buralux v. Council*, 1996 E.C.R. I-615, ¶¶ 83-85.

<sup>92</sup> Case C-11/95, *Comm'n v. Belgium*, 1996 E.C.R. I-4115, ¶¶ 52-53.

<sup>93</sup> Case C-233/94, *Germany v. Parliament*, 1997 E.C.R. I-2405, ¶ 26.

<sup>94</sup> Germany stated that "Community institutions must give detailed reasons why only the Community, to the exclusion of the Member States, is empowered to act in the area in question." *Id.* ¶ 23.

<sup>95</sup> The ECJ noted first that:

contain a statement of the reasons which led the institution to adopt them[.]”<sup>96</sup> An explicitly mentioned reference to the principle of subsidiarity is not required, however.<sup>97</sup> Furthermore, the Court explained that the principle of subsidiarity encompassed not only an element concerning the appropriateness of the legal intervention in question, but also an element concerning the intensity of this intervention. This analysis is dubious with respect to the legal simplicity of the E.U.’s judicial reasoning, because the analysis of the intensity of any E.U. legal intervention naturally falls in the ambit of the principle of proportionality. By referring to Protocol No. 2 on the Application of the Principles of Subsidiarity and Proportionality, the ECJ, unfortunately, seems to absorb one principle into the other without an additional unambiguous division between the fundamentals embraced by each principle respectively. Nevertheless, the economic analysis underlying the principle of subsidiarity differs from the one for the principle of proportionality. It seems, thus, that the ECJ should limit itself to the review of the principle of subsidiarity through the elements corresponding to this judicial review—the effectiveness test and the comparative efficiency test—rather than mixing in external elements such as the intensity of the action undertaken.

In *R v. Secretary of State for Health*, the ECJ affirmed that the principle of subsidiarity applies indistinguishably to E.U. institutions and Member States with

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As a preliminary point, it should be pointed out that in the context of this plea the German Government is not claiming that the Directive infringed the principle of subsidiarity, but only that the Community legislature did not set out the grounds to substantiate the compatibility of its actions with that principle.

*Id.* ¶ 24. Then, the ECJ assessed, through the Directive’s recital, whether or not the principle of subsidiarity had been infringed by the directive:

In the present case, the Parliament and the Council stated in the second recital in the preamble to the Directive that ‘consideration should be given to the situation which might arise if deposits in a credit institution that has branches in other Member States became unavailable’ and that it was ‘indispensable to ensure a harmonized minimum level of deposit protection wherever deposits are located in the Community’. This shows that, in the Community legislature’s view, the aim of its action could be best achieved at [the] Community level. The same reasoning appears in the third recital, from which it is clear that the decision regarding the guarantee scheme which is competent in the event of the insolvency of a branch situated in a Member State other than that in which the credit institution has its head office has repercussions which are felt outside the borders of each Member State. Furthermore, in the fifth recital the Parliament and the Council stated that the action taken by the Member States in response to the Commission’s Recommendation has not fully achieved the desired result. The Community legislature therefore found that the objective of its action could not be achieved sufficiently by the Member States. Consequently, it is apparent that, on any view, the Parliament and the Council did explain why they considered that their action was in conformity with the principle of subsidiarity.

*Id.* ¶¶ 26–28.

<sup>96</sup> *Id.* ¶ 25.

<sup>97</sup> “An express reference to that principle cannot be required.” *Id.* ¶ 28. In the *Biotechnology* case, the ECJ decided that the merely implicit reference to the appropriateness of the challenged norm in three of the directive’s recitals was sufficient for showing that this norm complied with the principle of subsidiarity. *Case C-377/98, Netherlands v. Parliament*, 2001 E.C.R. I-7079, ¶¶ 30–34.

regard to Article 95 TFEU, so that this Article does not confer exclusive competence on E.U. institutions to regulate the internal market.<sup>98</sup> Accordingly, the mere fact that a measure is adopted in order to implement Article 95 TFEU will not exempt it from E.U. judicial review for compliance with the principle of subsidiarity.

The ECJ's settled jurisprudence on judicial review for subsidiarity<sup>99</sup> demonstrates that this review is limited to procedural subsidiarity (i.e. judicial review of the grounds justifying the E.U. legal act) and not, as we shall see later, for substantive subsidiarity (i.e. judicial review of the comparative economic efficiency of the litigated act). This E.U. jurisprudence, therefore, contributes to the ongoing "proceduralization" of the principle of subsidiarity by the E.U. legislator.<sup>100</sup> It seems clear that judicial review of the procedural side of the principle of subsidiarity leaves a very wide margin of appreciation for the E.U. legislator to intervene when he or she deems it appropriate.

At this juncture, one possible explanation for this judicial behavior may be that the ECJ is incapable of undertaking the so-called comparative efficiency test that is intrinsic to the principle of subsidiarity.<sup>101</sup> Only the E.U. legislator has the information necessary to engage in such analysis. However, in passing the act, the E.U. legislator has specifically proclaimed his willingness to uphold the challenged E.U. legal act. At the outset of its case law, the ECJ adopted a very narrow approach towards the principle of subsidiarity. This approach consisted of accepting a great deal of compliance of the challenged E.U. legal act with procedural subsidiarity (e.g. not requiring explicit mentioning). The ECJ's decision to accept only an implicit reference to the principle of subsidiarity in order to review the compliance of a given E.U. legal act with the principle of subsidiarity means that the ECJ is not keen on requiring E.U. institutions to formally demonstrate the compatibility of a given E.U. act with the principle of subsidiarity. This judicial stance is characteristic of judicial self-restraint because the ECJ assumes the E.U. legislator to have correctly considered the subsidiarity principle at the time of the act's adoption. It suffices for the law to allude to the aptness of its existence for the ECJ to conclude that the E.U. legislator correctly enforced the principle of subsidiarity. Given the cumbersomeness of the E.U. decision-making process, however, which includes diverse E.U. institutions representative of different interests, including both supranational (Commission, Parliament) and national ones (Council), how could it be possible that an E.U. legal act could be adopted despite being inappropriate? To ensure that subsidiarity has been considered by the E.U. legislator, therefore, it is of paramount

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<sup>98</sup> Case C-491/01, *The Queen v. Sec'y of State for Health*, 2002 E.C.R. I-11453, ¶ 179.

<sup>99</sup> E.g., Joined Cases C-154 & C-155/04, *The Queen v. Sec'y of State for Health*, 2005 E.C.R. I-6451, ¶ 99; Case C-103/01, *Comm'n v. Germany*, 2003 E.C.R. I-5369, ¶ 47; Case C-377/98, *Netherlands v. Parliament*, 2001 E.C.R. I-7079, ¶ 32.

<sup>100</sup> Herve Bribosia, *Subsidiarité et répartition des compétences entre l'Union et ses Etats membres dans la Constitution européenne*, 1 REVUE DE DROIT DE L'UNION EUROPÉENNE 25, 54–58 (2005).

<sup>101</sup> De Búrca suggests that "the subsidiarity ('comparative efficiency') principle comes into play to determine whether particular aims can best be achieved by the Community or the Member States." Gráinne De Búrca, *The Principle of Subsidiarity and the Court of Justice as an Institutional Actor*, 36 J. COMMON MKT. STUD. 217, 219 (1998).

importance for the ECJ to require the E.U. legislator to demonstrate the appropriateness (meaning, the comparative efficiency) of the proposed legal act. This sort of circular argument, however puzzling, is certainly the most efficient for E.U. judges since it avoids substituting E.U. judicial reasoning for legislative reasoning.

Given the ECJ's adoption of hesitant but non-negligible case law on procedural subsidiarity, it follows that the ECJ would endorse a modest approach to substantive subsidiarity as well—a judicial strategy that is consistent with an efficiency rationale.

*B. The Efficiency of Judicial Self-Restraint Regarding Substantive Subsidiarity*

Regarding ECJ jurisprudence on substantive subsidiarity, the ECJ, in *Tobacco II*, insisted on the need to apply the principle of subsidiarity to a case that dealt with a directive designed to lift barriers to trade.<sup>102</sup> Lifting these barriers could not be legitimately achieved by Member States but could be done by the E.U. legislator, as held by the Court. In *Bosman*, the ECJ decided that the applicant's argument, based on the principle of subsidiarity, could not justifiably prevail over the defendant's argument that the measure deprived individuals of the fundamental freedoms derived from the Treaties.<sup>103</sup> Accordingly, the ECJ seems to prioritize economic freedoms over subsidiarity. More decisively, in *Working Time Directive*, the U.K. asked the ECJ to annul a directive (or to declare null and void some articles of a directive) that restricted the maximum working time authorized per week throughout the E.U.<sup>104</sup> In the midst of other arguments, the U.K. challenged the directive on the grounds of subsidiarity:

[T]he Community legislature neither fully considered nor adequately demonstrated whether there were transnational aspects which could not be satisfactorily regulated by national measures, whether such measures would conflict with the requirement of the EC Treaty or significantly damage the interests of Member States or finally, whether action at Community level would provide clear benefits compared with action at national level. In its submission, Article 118a should be interpreted in the light of the principle of subsidiarity, which does not allow adoption of a directive in such wide and prescriptive terms as the contested Directive, given that the extent and the nature of legislative regulation of working time vary very widely between Member States. The applicant explains in this context, however, that it does not rely upon infringement of the principle of subsidiarity as a separate plea.<sup>105</sup>

After that, the UK pithily argued with respect to the principle of subsidiarity: "Nor, moreover, does the Preamble of the Directive explain why the Community action was necessary."<sup>106</sup> The answer of the ECJ is clear in its readiness to reaffirm

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<sup>102</sup> Case C-491/01, *The Queen v. Sec'y of State for Health*, 2002 E.C.R. I-11453, ¶¶ 179–85.

<sup>103</sup> Case C-415/93, *Union royale belge des sociétés de football association ASBL v. Bosman*, 1995 E.C.R. I-4921.

<sup>104</sup> Case C-84/94, *U.K. v. Council*, 1996 E.C.R. I-5755, ¶ 9.

<sup>105</sup> *Id.* ¶ 46.

<sup>106</sup> *Id.* ¶ 72.

its vow of self-restrained judicial review of the principle of subsidiarity. The ECJ held that "it is to be remembered that it is not the function of the Court to review the expediency of measures adopted by the legislature. The review exercised under Article 173 must be limited to the legality of the disputed measure."<sup>107</sup>

Then, the ECJ explicated its eagerness not to interfere with the E.U. legislator in his exercise of powers shared by the E.U.'s institutions and its Member States:<sup>108</sup>

Once the Council has found that it is necessary to improve the existing level of protection as regards the health and safety of workers and to harmonize the conditions in this area while maintaining the improvements made, achievement of that objective through the imposition of minimum requirements necessarily presupposes Community-wide action, which otherwise, as in this case, leaves the enactment of the detailed implementing provisions required largely to the Member States . . . [t]he argument of non-compliance with the principle of subsidiarity can be rejected at the outset. It is said that the Community legislature has not established that the aims of the Directive would be better served at Community level than at national level. But that argument, as so formulated, really concerns the need for Community actions, which has already been examined in paragraph 47 of this judgment.<sup>109</sup>

When the E.U. is competent to act, then the supremacy of E.U. law prevails and Member States are prohibited from enforcing measures that violate the E.U.'s legal acts. Member States are permitted to act subsequent to the passage of an E.U. legal act only to the extent that the national (or local) measures adopted are compatible with the E.U. ones. This judicial stance is similar to the U.S. Supreme Court's doctrine of pre-emption. The vertical distribution of power between the American federal government and the States has been detailed in Executive Order 12612.<sup>110</sup> This Executive Order is the best U.S. counterpart to the European notion of subsidiarity. In its preamble, the Order states that it was adopted "in order to restore the division of governmental responsibilities between the national government and the States that was intended by the Framers of the Constitution and to ensure . . . the principles of federalism established by the Framers[.]"<sup>111</sup> Between the late 1980s and 1990s, there was a period of enhanced decentralization in both the U.S. and the E.U.

<sup>107</sup> *Id.* ¶ 23.

<sup>108</sup> The ECJ regularly avoids answering the question of whether or not a Member State violated the principle of subsidiarity. The ECJ prefers, if the legal basis of the E.U. legal act is questionable, to focus on this issue rather than delve into the debate over the principle of subsidiarity. A telling example of this is *Tobacco Advertising*. In that case, Germany challenged Directive 98/43 through an annulment procedure by saying that the principle of subsidiarity had been violated. The ECJ annulled the directive not on the grounds of the principle of subsidiarity, but by stating that the wrong legal basis had been chosen by the E.U. legislator when he adopted the directive. In this way, the ECJ did not have to assess the presence or absence of an infringement of the principle of subsidiarity. Case C-376/98, *F.R.G. v. Parliament & Council*, 2000 E.C.R. I-8419, ¶¶ 99, 111. This judicial reasoning is used in *Biotechnology*, in which the ECJ rejected the allegation that Directive 98/44 infringed the principle of subsidiarity with only two short paragraphs (¶¶ 32–33). Case C-377/98, *Netherlands v. Eur. Parliament & Council*, 2001 E.C.R. I-7079, ¶¶ 32–33.

<sup>109</sup> Case C-84/94, *U.K. v. Council*, 1996 E.C.R. I-5755, ¶¶ 47, 55.

<sup>110</sup> Exec. Order No. 12,612, 3 C.F.R. § 252 (1987).

<sup>111</sup> *Id.* pmbl.

For the U.S., it was through this Order in 1987; for the E.U., it was through the principle of subsidiarity enshrined in the Single European Act of 1986 (for environmental matters) and later in the 1992 Maastricht Treaty (for general matters). Yet, this decentralizing push by the political leaders of the time must be tempered by the very political nature of decentralization. These political concerns deterred both Courts—the U.S. Supreme Court and the ECJ—from interfering with the exercise of shared powers. A doctrine of implicit pre-emption (what one may call “dormant pre-emption”) creates the risk of the jettisoning federalism and the autonomy of the States since this implicit doctrine carries a centralizing bias against federalism (which is understood as synonymous with decentralization).<sup>112</sup>

In *Amsterdam Bulb*, the ECJ interpreted an absence of the express mention of pre-emption in the contested measure as equivalent to an authorization for Member State action.<sup>113</sup> This conclusion, however, was not followed by the ECJ in the *Officier van Justitie* case, in which the ECJ decided that, despite the silence of the E.U. legislator regarding the ability of Member States to act after the E.U. has intervened in a particular field, Member States were preempted from acting because the contested directive was already in force.<sup>114</sup> The Lisbon Treaty clarified the E.U. doctrine of pre-emption not only through an explicit vertical distribution of powers (Title I TFEU),<sup>115</sup> but especially with Article 2 TFEU, which states:

1. When the Treaties confer on the Union exclusive competence in a specific area, only the Union may legislate and adopt legally binding acts, the Member States being able to do so themselves only if so empowered by the Union or for the implementation of Union acts.
2. When the Treaties confer on the Union a competence shared with the Member States in a specific area, the Union and the Member States may legislate and adopt legally binding acts in that area. The Member States shall exercise their competence to the extent that the Union has not exercised its competence. The Member States shall again exercise their competence to the extent that the Union has decided to cease exercising its competence.<sup>116</sup>

The U.S. Supreme Court has repeatedly used the doctrine of pre-emption in order to federalize a number of powers, most notably in environmental law.<sup>117</sup>

<sup>112</sup> JESSE H. CHOPER, JUDICIAL REVIEW AND THE NATIONAL POLITICAL PROCESS: A FUNCTIONAL RECONSIDERATION OF THE ROLE OF THE SUPREME COURT 175–84 (1980); Larry D. Kramer, *Putting the Politics Back into the Political Safeguards of Federalism*, 100 COLUM. L. REV. 215, 290–93 (2000).

<sup>113</sup> Case 50/76, *Amsterdam Bulb BV v. Produktschap voor Siergewassen*, 1977 E.C.R. 137, ¶¶ 26–29.

<sup>114</sup> Case C-111/76, *Officier van Justitie v. Beert van den Hazel*, 1977 E.C.R. 901, ¶ 16.

<sup>115</sup> Regarding the ex ante clarification of the prerogatives of the Union, Alesina et al. demonstrate that a union where prerogatives are fixed ex ante leads to superior outcomes since potential members do not stay out, thus leading to an optimal size of the union. Alberto Alesina et al., *The Political Economy of International Unions* (Harvard Inst. of Econ. Research, Discussion Paper No. 1939, 2001), available at <http://www.economics.harvard.edu/pub/hier/2001/HIER1939.pdf>.

<sup>116</sup> TFEU art. 2.

<sup>117</sup> For example, the Supreme Court, in *International Paper Co. v. Ouellette*, 479 U.S. 481, 494–97 (1987) and *City of Milwaukee v. Illinois*, 451 U.S. 304, 320–23 (1981), held that federal regulations grounded in the Clean Water Act pre-empted state regulations, leaving states only residual powers for creating stricter environmental standards.

Justice Antonin Scalia believes that there is a resemblance between the European notion of subsidiarity and the American concept of pre-emption in U.S. federalism.<sup>118</sup> The U.S. doctrine of pre-emption is present in E.U. jurisprudence<sup>119</sup> under a different lexicon, though the principle of the primacy of E.U. law is preferred.<sup>120</sup> When E.U. institutions have acted, the ECJ considers the Member States to have lost their power to act autonomously<sup>121</sup> in order to safeguard the primacy of E.U. law.<sup>122</sup> When the E.U. has shared powers according to Article 2(2) TFEU, there might be a conflict of powers without a conflict of legal rules: the principle of subsidiarity comes to the forefront, but the doctrine of pre-emption (or principle of primacy of E.U. law) perpetuates. Consequently, if the principle of subsidiarity governs the efficiency of multi-level governance, the doctrine of pre-emption guarantees the effectiveness of E.U. legal acts without prejudging the efficiency of these acts.

Cases such as *Centros*<sup>123</sup> and *Überseering*<sup>124</sup> considerably altered E.U. corporate law by introducing the sort of regulatory competition that was already at play in the

<sup>118</sup> George A. Bermann, *Taking Subsidiarity Seriously: Federalism in the European Community and the United States*, 94 COLUM. L. REV. 331, 406 (1994) (taken from Antonin Scalia, *Subsidiarity à l'Américaine: C'est à Dire Preemption*, in MAASTRICHT, SUBSIDIARITY AND ITALIAN-EC RELATIONS 4, 4 (1992)).

<sup>119</sup> See Case C-222/82, *Apple & Pear Dev't Council v. K. J. Lewis Ltd.*, 1983 E.C.R. 4083, ¶ 33; Case 159/73, *Hannoversche Zucker v. Hauptzollamt Hannover*, 1974 E.C.R. 212, ¶ 4. In *United States v. Lopez*, 514 U.S. 549 (1995), the Supreme Court refused to admit that a federal prohibition to carry firearms near schools concerned the Commerce Clause. Hence, because Congress was found to lack the necessary legal basis for intervening, this law was overruled by the Supreme Court. This case goes against what had been an ongoing federalization of the exercise of power in the U.S. since the New Deal, with the holding being later confirmed. *Solid Waste Agency of N. Cook County v. U.S. Army Corps of Eng'rs*, 531 U.S. 159, 174 (2001); *United States v. Morrison*, 529 U.S. 598, 613 (2000). This case law is in line with the case *McCulloch v. Maryland*, where the Supreme Court said “[the U.S.] government is acknowledged by all to be one of enumerated powers.” *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 405 (1819).

<sup>120</sup> Martin A. Field details this double test as follows: “[f]irst, a court should ask whether the issue before it is properly subject to the exercise of federal power; if it is, the court should go on to determine whether, in light of the competing state and federal interests involved, it is wise as a matter of policy to adopt a federal substantive rule to govern the issue.” Martin A. Field, *Sources of Law: The Scope of Federal Common Law*, 99 HARV. L. REV. 883, 886 (1986).

<sup>121</sup> The E.U. doctrine of pre-emption has been implicitly manifested in cases such as *Cerafel*, where the ECJ declared that “whether and to what extent Regulation 1035/72 precludes the extension of rules established by producers’ organizations to producers who are not members, either because the extension of those rules affects a matter with which the common organization has dealt exhaustively or because the rules so extended are contrary to the provisions of Community law or interfere with the proper functioning of the common organization of the market.” Case 218/85, *Cerafel v. Le Campion*, 1986 E.C.R. I-3513; see also Eugene D. Cross, *Pre-Emption of Member State Law in European Economic Community: A Framework Analysis*, 29 COMMON MKT. L. REV. 447 (1992); Michel Waelbroeck, *The Emergent Doctrine of Community Pre-emption—Consent and Re-delegation*, in 2 COURTS AND FREE MARKETS 570 (1982); Stephen Weatherill, *Beyond Preemption? Shared Competence and Constitutional Change in the European Community*, in LEGAL ISSUES OF THE MAASTRICHT TREATY 13–33 (David O’Keeffe & Patrick Twomey eds., 1994).

<sup>122</sup> See Case 35/76, *Simmenthal v. Ministero delle Finanze*, 1976 E.C.R. 1871. National rules infringing E.U. law do not exist for the ECJ. Joined Cases C-10/97 to C-22/97, *Ministero delle Finanze v. IN.CO.GE.'90*, 1998 E.C.R. I-6307.

<sup>123</sup> Case C-212/97, *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*, 1999 E.C.R. I-1459.

<sup>124</sup> Case C-208/00, *Überseering BV v. Nordic Construction Baumanagement GmbH*, 2002 E.C.R. I-9919.



U.S. Supreme Court jurisprudence has generally left the regulation of corporate law to the States.<sup>125</sup> Companies are free to choose the State in which they will incorporate. This engenders competition among the States to promulgate laws and taxation schemes that are favorable to corporations. Clearly, the State of Delaware has benefited from this competition for reasons (race to the bottom or race to the top) that are debatable.<sup>126</sup> In the same vein, the ECJ deemed it unnecessary to restrict a firm's ability to incorporate in the territory in which the firm was most commercially active. The requirement laid down by a national law stating that a firm seeking incorporation in a Member State must be commercially active in that State constitutes an obstacle to the freedom of establishment guaranteed by Articles 49 and 54 of the TFEU—an obstacle that is unjustifiable in light of imperative requirements in the general national interest.<sup>127</sup> As a result, in the absence of a harmonized E.U. legal rule regarding incorporation,<sup>128</sup> Member States still safeguard their powers in regulating the taxes and regulatory regimes applicable to firms established in their jurisdictions (principle of subsidiarity). This is true only to the extent that it does not hinder the freedom of establishment (principle of economic efficiency). As one can see, the E.U. judge promotes regulatory and fiscal competition through the defense of the economic freedoms enshrined in the E.U. Treaties so that, when the principle of subsidiarity is applicable, economic efficiency is nonetheless preserved. The doctrine of pre-emption and the principle of subsidiarity have the vertical division of powers as common ground.<sup>129</sup> The key U.S. constitutional provision on the division of power between the federal government and the States is the Tenth Amendment:

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or the people.<sup>130</sup>

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<sup>125</sup> See, e.g., Curtis Alva, *Delaware and the Market for Corporate Charters: History and Agency*, 15 DEL. J. CORP. L. 885, 887 (1990); Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709 (1987); Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977).

<sup>126</sup> See Leo Herzl & Laura D. Richman, *Delaware's Preeminence by Design, Foreword to I.R. FRANKLIN BALOTTI & JESSE A. FILKESTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS* (3d ed. 2009).

<sup>127</sup> See John Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 43 (1985). This jurisprudence of *Centros* and *Überseering* goes against the corporate laws of the Netherlands, UK, Ireland, Denmark, Finland, and Switzerland. Corporate laws in Europe have largely adopted the doctrine in which the nationality of a firm, and the laws to which it is therefore subject, turns on in which member state the firm has its headquarters—the “real seat doctrine” (contrary to the “incorporation State doctrine”).

<sup>128</sup> Over time, E.U. corporate law has been incrementally harmonized. See Brian Bercusson, *Episodes on the Path Towards the European Social Model: The EU Charter of Fundamental Rights and the Convention on the Future of Europe*, in THE FUTURE OF LABOUR LAW: LIBER AMICORUM BOB HEPPLE QC 179, 190 (Catherine Barnard et al. eds., 2004).

<sup>129</sup> See Case 111/76, *Officier van Justitie v. Beert van den Hazel*, 1977 E.C.R. 901; Case 148/78, *Pubblico Ministero v. Ratti*, 1979 E.C.R. 1629. Once the E.U. has harmonized a domain, Member States may act only to the extent that their actions do not hinder intra-E.U. trade. Case 28/84, *Comm'n v. Germany*, 1985 E.C.R. 3097; Case 120/78, *Rewe-Zentrale AG v. Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)*, 1979 E.C.R. 649. See generally A. Goucha Soares, *Pre-emption, Conflict of Powers and Subsidiarity*, 23 EUR. L. REV. 132 (1998).

<sup>130</sup> U.S. CONST. Amend. X, §1.

The Supreme Court interpreted this Amendment in *United States v. Derby*,<sup>131</sup> where it “vanquished the view that an otherwise valid exercise of a delegated or implied power by the federal government could be blocked by the states under the Tenth Amendment.”<sup>132</sup> The Supreme Court has been disinclined to review the distribution of powers for the implementation of the Commerce Clause. The ECJ’s subsidiarity jurisprudence is similar to the Supreme Court’s Tenth Amendment jurisprudence because both tribunals assume that the legislature has considered the economic rationale of legal intervention. In the U.S., this deference is called formal rationality and in the E.U. it is called procedural subsidiarity. Likewise, both tribunals apply minimal judicial review to the economic rationale underpinning the legislature’s legal intervention. In the U.S., this forgiving standard is called rational basis review while in the E.U. it is called substantial subsidiarity.<sup>133</sup> These similar judicial approaches may be regarded as considering economic efficiency by conditioning the validity of the legislature’s legal intervention on the legislature’s consideration of the efficiency gains or losses emanating from potential legal intervention. However, both tribunals minimize the costs of judicial error by espousing restrained approaches with regard to their review of the economic

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<sup>131</sup> *United States v. Derby*, 312 U.S. 100, 124 (1941) (the Supreme Court stated, “the [Tenth] amendment states but a truism that all is retained which has not been surrendered. There is nothing in the history of its adoption to suggest that it was more than declaratory of the relationship between the national and state governments as it had been established by the Constitution before the Amendment or that its purpose was other than to allay fears that the new national government might seek to exercise powers not granted, and that the states might not be able to exercise fully their reserved powers.”).

<sup>132</sup> G. Vause, *Subsidiarity Principle in European Union Law—American Federalism Compared*, 27 CASE W. RES. J. INT’L L. 61, 70 (1995).

<sup>133</sup> See *Gibbons v. Ogden*, 22 U.S. (9 Wheat) 1, 196 (1824), where the Supreme Court affirmed that congressional power over interstate commerce is “complete in itself, may be exercised to its utmost extent, and acknowledges no limitations, other than are prescribed in the Constitution.” The Supreme Court’s judicial self-restraint in interstate commerce clause cases has galvanized into firm precedent, summed up in *Hodel v. Virginia Surface Mining and Reclamation Association*, 452 U.S. 264, 276 (1981), in which the Court stated that it “must defer to a congressional finding that a regulated activity affects interstate commerce, if there is any rational basis for such finding.” Supreme Court jurisprudence regarding the balance of state and federal power reveals that the Supreme Court endorses a minimalist approach tantamount to the one taken by the ECJ. Nevertheless, the Supreme Court seems to justify this approach more explicitly than the ECJ. The Supreme Court grounds its restraint in the notion that the legislature is better suited than the judiciary to assess further federalization or decentralization—a rationale that is chiefly economic rather than legal. Indeed, in *Wickard v. Filburn*, 317 U.S. 111, 125 (1942), the Supreme Court stated that whenever economic an interjurisdictional linkage is contemplated, Congress may act independent of the Commerce Clause. Indeed, “even if appellee’s activity be local and though it may not be regarded as commerce, it may still, whatever its nature, be reached by Congress if it exerts a *substantial economic effect on interstate commerce* and this irrespective of whether such effect it what might at some earlier time have been defined as ‘direct’ or ‘indirect’” (emphasis added). Therefore, the Supreme Court’s self-restraint on the Tenth Amendment (which may be the closest U.S. constitutional provision to the E.U.’s subsidiarity principle) led Vause to conclude that “there has been no Supreme Court decision in the last fifty years setting aside a finding by Congress in support of legislation based upon the Commerce Clause on the grounds that such finding was without rational basis. It therefore appears that if Congress does articulate formal findings when it passes such legislation to show why it considers the matter to be subject to its regulatory power under the Commerce Clause, it is unlikely that the courts would view such a finding as ‘irrational’.” Vause, *supra* note 132, at 78. Hence, the Supreme Court only looks at whether Congress has clearly (but not necessarily expressly) stated that the legal intervention has a(n) (economic) rationale (what would be called procedural subsidiarity in the E.U.); however, the Supreme Court expressly does not review the economic rationality itself (what would be called substantial subsidiarity in the E.U.). *Id.*

efficiency of a specific legal intervention. The comparative approach teaches us that the respective practices of federalism, as understood by the Supreme Court, and of subsidiarity, as understood by the ECJ, may be regarded as very similar in the sense that both Courts' interpretations are often characterized by self-restraint and economic considerations. The self-restraint of the tribunals reveals that political decision-makers can assess the efficiency consideration that is inherent to the principles of subsidiarity and federalism<sup>134</sup> more effectively than judges because of the informational costs that would stem from the judiciary's efforts to assess the economic rationality of a particular law.<sup>135</sup> The precise contours of the cost-benefit analysis that the judiciary would employ are so variable and subjective that it may very well be impossible for judges to reach uniform determinations.

Regarding the inconsistencies of the contours of economic review, a system cannot overcome the challenge of an optimal distribution of competencies simply by establishing overlapping and task-specific jurisdictions; in fact, the optimal degree of decentralization or centralization, as the case may be, must be ascertained on a case-by-case basis.<sup>136</sup>

"[W]hen allowing for political economy considerations, straightforward normative conclusions on the appropriate degree of centralization are much more difficult to draw. The use of generalised second best arguments requires a case-by-case approach and careful empirical analysis."<sup>137</sup> The self-restrained judicial review exercised by the U.S. Supreme Court regarding the scope and appropriateness of federal regulation is, as much as the self-restrained E.U. judicial review on subsidiarity, due to the asymmetric access to information between the judiciary, which holds modest information by comparison to the legislature (and administration).<sup>138</sup> This judicial self-restraint reflects the Supreme Court's

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<sup>134</sup> Nevertheless, A. Alesina et al. empirically proves that the E.U. is "too involved in certain areas where economies of scale seem low and heterogeneity of preferences high and not involved enough in others, which, in principle should have the opposite characteristics." A. Alesina et al., *What does the European Union do?*, 123 PUB. CHOICE 275, 312 (2005). This interesting insight does not subvert this article's analysis claiming that the E.U. legislature is better suited to assess the information. Indeed, the misallocation of powers resulting from the E.U. legislature's choices may certainly have been greater had the E.U. judges been in charge of this allocation of power. Therefore, this article affirms that the E.U. legislator does not avoid costs due to misallocation of E.U. powers, but merely minimizes these costs when compared to the E.U. judges' alternative assessments. See also E. Carbonara et al., *Self-Defeating Subsidiarity*, 5 REV. OF L. & ECON. 741 (2009) (arguing that the principle of subsidiarity has led to excessive centralization, despite its incorporation into the E.U. Treaties). Here again, the misuse of relevant information by the E.U. legislator may hardly be greater than what it would have been if E.U. judges were responsible for the allocation of vertical powers, and the ECJ cannot be blamed for these E.U. legislative errors.

<sup>135</sup> For a study of the absence of subsidiarity in American constitutionalism, see G. Bermann, *Subsidiarity as a Principle of US Constitutional Law*, 42 AM. J. COMP. L. 555, 566 (1994) (arguing that the lack of subsidiarity principle in the U.S. Constitution may reveal a confidence in US federalism).

<sup>136</sup> Fitz Breuss & Markus Eller, *The Optimal Decentralisation of Government Activity: Normative Recommendations for the European Constitution*, 15 CONST. POL. ECON. 27, 38 (2004).

<sup>137</sup> T. Persson et al., *The Theory of Fiscal Federalism: What does it Mean for Europe?*, in QUO VADIS EUROPE? 23–41 (H. Siebert ed., 1997).

<sup>138</sup> Indeed, courts have less information with respect to the decision-making process than do the legislature or the administration. Furthermore, time-constraint is greater for courts compared to legislature and administration with respect to the analysis of information. Justice Powell said that the "information

unwillingness to meddle with the appropriateness of further decentralization or further harmonization in a specific case. Once a branch of government can exercise a power, the power must be “complete in itself, may be exercised to its utmost extent, and acknowledges no limitations, other than are prescribed in the Constitution.”<sup>139</sup> The fundamental quandary inherent to the exercise of powers involving different levels of governance is common to both the U.S. and E.U. and can rarely be solved by a passive agent such as a judge.<sup>140</sup>

At this point, the article argues that the self-restrained E.U. judicial behavior on the principle of subsidiarity is the best strategy because of the ambivalent efficiency consequences that stem from implementing subsidiarity.<sup>141</sup> In his manuscript on the minimalist judge, Sunstein argues:

My suggestion is that the notion of “passive virtues” can be analysed in a more productive way if we see that notion as part of judicial minimalism and as an effort to increase space for democratic choice and to reduce the costs of decision and the costs of error.<sup>142</sup>

Subsequently, he affirms that a minimalist approach certainly minimizes the cost of judicial error when the context is favorable:

In this light it would be foolish to suggest either that minimalism is generally a good strategy or that minimalism is generally blunder. Everything depends on contextual considerations. The only point that is clear even in the abstract is that sometimes the minimalism approach is the best way to minimize the sum of error costs and decision costs.<sup>143</sup>

The principle of subsidiarity is a principle of governance, not a principle of adjudication. The principle of subsidiarity contains the seeds of economic efficiency both theoretically (the economics of multi-level governance) and legally (the legal

and expertise that Congress acquires in the consideration and enactment of earlier legislation [may be sufficient where] Congress has legislated repeatedly in an area of national concern.” *Fullilove v. Klutznick*, 448 U.S. 448, 503 (1980). Regarding the E.U., see J.P. Jacqué & J.H.H. Weiler, *On the Road to the European Union—A New Judicial Architecture: An Agenda for the Intergovernmental Conference*, 27 COMMON MKT. L. REV. 185, 204 (1990) which states that “it is particularly troubling if a majority of Member States, or even *all* Member States. . . . decide that something does comply with the principle of subsidiarity, for the Court to overturn such a decision.”

<sup>139</sup> *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 196 (1824).

<sup>140</sup> See L. Ribstein & B. Kobayashi, *Economics of Federalism* (Illinois Law and Economics, Working Paper No. LE06-001, 2006), available at <http://law.bepress.com/uiuclwps/papers/art49/> (“A fundamental dilemma of federalism is how to have a central government that is strong enough to provide a check on the lower level governments, but is not so strong that it overwhelms the states. This dilemma is a difficult one, because state governments cannot easily prevent the central government from seizing power other than by seceding, which would destroy the union, or by refusing to empower the central government at the outset. Thus, federalism must be self-enforcing.”).

<sup>141</sup> This article defines judicial activism and judicial self-restraint in the way Hjalte Rasmussen has defined these notions. Judicial activism “connotes regular judicial policy-making in pursuance of policy-objectives which usurp the role and policy,” while judicial self-restraint is “commonly used to designate the situation in which judges defer their judgments to some extent . . . to the political branches of government.” HJALTE RASMUSSEN, *THE EUROPEAN COURT OF JUSTICE* 26–27, 33 (1998).

<sup>142</sup> CASS R. SUNSTEIN, *ONE CASE AT A TIME: JUDICIAL MINIMALISM ON THE SUPREME COURT* 40 (2001).

<sup>143</sup> SUNSTEIN, *supra* note 142, at 50.

reasoning derived from the comparative efficiency test enshrined in the E.U. Treaties). Yet, the judiciary may not reasonably construe the principle of subsidiarity so that efficiency is maximized because of the high informational asymmetry between judges and the legislature. Consequently, there are high error costs in any court's effort to implement subsidiarity. These costs are fortified by subsidiarity's ambiguous economic consequences. Therefore, an E.U. judge minimizes error-costs by practicing restraint, while the legislature minimizes administrative costs through multi-level governance. The settled E.U. jurisprudence on subsidiarity not only adopts a minimalist approach on substantial subsidiarity, but also thoroughly reviews the procedural side of subsidiarity, thereby maximizing its economic efficiency. Furthermore, the disinclination of the ECJ to exercise judicial review over substantial subsidiarity issues minimizes judicial error costs since asymmetry of information is high for the Court when compared with the E.U. legislature. On the other hand, complete judicial review of procedural subsidiarity minimizes decisional costs since the E.U. judge ensures that the E.U. legislature has considered subsidiarity alongside the efficiency consequences it holds during the course of its legislative process.

Because judges do not hold the necessary information, they assume that the deal struck by the legislature has considered the costs and benefits of centralized or decentralized regulation. Bermann argues that:

One's judgment about whether a measure comports with the principle of subsidiarity is a profoundly political one, in the sense that it depends intimately on one's assessment of the measure's merits . . . [t]he Court is not, however, especially well-equipped to make [this] substantive judgment[.]<sup>144</sup>

Consequently, since the judge may only bear out the previously adopted decision, the decision is assumed to have been based upon a level of information higher than what the judge would assume if he or she were reconsidering the political decision. Had the judge deemed it necessary to reassess the legislature's decision to exercise specific powers in a specific pattern, the judiciary would likely be accused of attempting to replace the political institutions. Error costs would be largely increased if E.U. judges chose to engage in what Bermann calls "a subsidiarity impact analysis."<sup>145</sup> With regard to the restrained E.U. legislative law-making ingrained in the principle of subsidiarity, it is understandable that one may legitimately consider a self-restrained form of E.U. judicial law-making to be a viable solution to the ECJ's legitimacy problems.<sup>146</sup> This judicial stance shelters the ECJ from potential criticism emanating from its interference in the political arena, hence avoiding a promising reproof of a "government of E.U. judges." Each time that the European institutions intervene in a particular field, they assume that only the European institutions are able to ameliorate the particular field. Therefore, the study of the economic considerations leading to further harmonization (such as

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<sup>144</sup> Bermann, *supra* note 10, at 335–36.

<sup>145</sup> *Id.* at 379.

<sup>146</sup> Without delving into the immense literature on the E.U. democratic deficit, see ESTELLA, *supra* note 74, at 43–53 for a survey.

externalities, homogeneity of preferences, or even a regulatory race to the bottom) is dismissed by the ECJ as a viable ground for judicial review.

The judicial error costs are important. They are even more important when tribunals seek to implement subsidiarity. Indeed, subsidiarity implicates different decision-makers exercising powers on a vertical plane, whereby once the exercise of a specific power has been delegated to a certain level of governance, this power cannot be taken away judicially (rather, it may only be changed through constitutional mechanisms). The judicial self-restraint reflected in the ECJ's jurisprudence on substantial subsidiarity is the most efficient strategy for the ECJ not only because it avoids incurring current error costs but also because it minimizes the error costs that would potentially be incurred overall by judicial activism in the field of substantial subsidiarity.

The costs that the E.U. judges would create if they were to miscalculate an efficient exercise of powers can be called "Error Costs Type I," which refers to the judicial error cost of commission. The costs potentially borne by society if E.U. judges leave it to the decision-makers—who would inappropriately use the information they have to assign the exercise of powers—can be called "Error Costs Type II," which refers to the judicial error costs of omission.<sup>147</sup> It is fair to argue that Error Costs Type I are much greater than Error Costs Type II.<sup>148</sup> First, Error Costs Type II do not include political costs since judges, unlike legislators, do not engage in vertical misallocation of powers. Secondly, Error Costs Type II enable a more flexible answer in order to correct an inappropriate exercise of powers. Indeed, the legislator can just barely surmount a constitutional judicial ruling setting out an unmistakable exercise of powers because the only possible redress would be to adopt a constitutional (or treaty) amendment. On the other hand, the legislator can easily remedy a misallocation of powers created by the legislative branch by a mere legislative act. Lastly, and most importantly, Error Costs Type II have a much lower probability of incurring major costs. The E.U. judges do not have and cannot obtain information regarding the most efficient exercise of powers. On the other hand, the political branches (the European Parliament, the Council and the European Commission) have the relevant information and are sufficiently staffed to process such information optimally. As a consequence, it is safe to state that the probability of misuse of information is minimized when E.U. judges largely defer to the E.U. legislature regarding the exercise of power between the E.U. and the Member States. Consequentially, judicial self-restraint in the E.U. regarding subsidiarity is the optimal strategy because such restraint minimizes judicial error costs.

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<sup>147</sup> For a similar reference to the two kinds of judicial error costs, see Richard Epstein, *Judicial Review: Reckoning on Two Kings of Error*, in *ECONOMIC LIBERTIES AND THE JUDICIARY* 39 (James A. Dorn and Henry G. Mann eds., 1987) (criticizing Justice Scalia's willingness to minimize the judicial error cost of commission but failure to consider the judicial error costs of omission).

<sup>148</sup> See M. Rizzoli & L. Stanca, *Judicial Errors and Crime Deterrence: Theory and Experimental Evidence* (Università degli Studi di Milano, Dipartimento di Economia Politica "Bicocca", Working Paper No. 170, 2009), available at <http://ideas.repec.org/p/mib/wpaper/170.html> for theoretical and experimental evidence of dissymmetry of burdens between the two types of judicial error costs. The authors, in the field of criminal liability, show that judicial Error Cost Type I (conviction of an innocent) can be larger than judicial Error Cost Type II (acquittal of a guilty individual).

## III. CONCLUSION

Estella argues that the ECJ's jurisprudence regarding the principle of subsidiarity may be explained by the willingness of E.U. judges to facilitate European integration.<sup>149</sup> Still, this article's analysis reveals that the ECJ's subsidiarity jurisprudence is most effectively explained by considering the different prospective error costs that stem from the E.U. judges' opaque understanding of subsidiarity's economic consequences. Through the minimization of judicial error costs, E.U. judges choose a self-restrained justice in which the E.U. legislators are responsible for the allocation of powers since the E.U. legislature has the lowest informational access costs.

This paper has uncovered that the principle of subsidiarity encompasses the principle of economic efficiency. Additionally, this article argues that the ECJ's understanding of subsidiarity partakes in the enhancement of the principle of economic efficiency through the minimization of the judicial error costs given the ambivalent economic consequences of the principle of subsidiarity as comprehended by the E.U. judge. This paper has attempted to prove that the ECJ's subsidiarity jurisprudence is economically sound. The subsidiarity principle encompasses an efficiency rationale since efficiency considerations underpin the European Treaties. Besides, the ECJ has sanctioned subsidiarity's efficiency rationale (explicitly or implicitly) in forging the delicate division between procedural and substantial subsidiarities and ensuring that the E.U. legislature maximizes, while the ECJ minimizes, judicial error costs. Therefore, this principle is a desirable principle.

In conclusion, the subsidiarity principle is the right rule, in the right place, and at the right time.<sup>150</sup> Between the formalism that considers subsidiarity to be a regular E.U. legal principle and the nihilism that considers subsidiarity to be a sheer E.U. political principle, this article revealed that the economic approach pragmatically allows for an improved understanding of subsidiarity's rationale and its related ECJ jurisprudence.

## ANNEX I

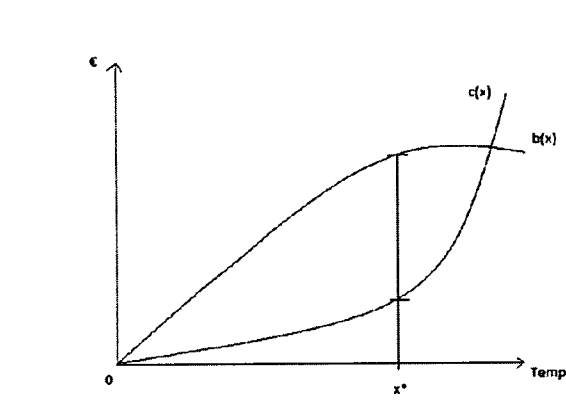
Because legal diversity is tantamount to an increase in transaction costs and therefore gives rise to trade barriers, any government should a priori prefer legal harmonization. However, as detailed above, the harmonizing process, insofar as it requires full decentralization, incurs costs and benefits respectively. This brings about the need for reducing the costs incurred by legal harmonization up to the point where the marginal benefit of this reduction of transactional costs equals the marginal cost of further decentralization. The costs incurred by legal harmonization,  $c(x)$ , can be illustrated by a convex curve since the first legal norms that are harmonized touch upon the outer core sovereignty of the State, and thus incur

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<sup>149</sup> ANTONIO ESTELLA, *THE PRINCIPLE OF SUBSIDIARITY AND ITS CRITIQUE* (2002).

<sup>150</sup> This explicitly contradicts Gravis' assessment of subsidiarity as "the wrong rule, in the wrong place, at the wrong time." G. Davies, *Subsidiarity as a Method of Policy Centralisation*, 43 *COMMON MKT. L. REV.* 63, 66 (2006).

limited societal costs from the perspective of the sovereignty. Hence, the cost of legal harmonization are  $c(0)=0$ ,  $c'(\cdot)>0$ ,  $c''(0)>0$  et  $c''(\cdot)>0$ . On the other hand, the benefits of legal harmonization may legitimately be assumed to be illustrated by a concave curve because the first legal norms that are harmonized generally relate to the easing of commerce, whereas the legal norms that are later integrated touch upon the legal culture of the jurisdiction whereby the net benefits (easing of commerce minus the political and societal costs) are diminished. Hence, the benefits of legal harmonization are  $b(0)=0$ ,  $b'(\cdot)<0$ ,  $b''(0)<0$  et  $b''(\cdot)<0$ . When the costs are greater than the expected benefits of further centralization, it becomes obviously inefficient to keep strengthening the harmonization above a point represented by  $x^*$  in the figure below:



Consequently, a level of optimal centralization exists (as does a level of optimal decentralization)<sup>151</sup> and is illustrated by  $x^*$  whereby the costs of multi-level governance are minimized.<sup>152</sup> Because of the respective costs and benefits attached to both subsidiarity and legal harmonization, the most efficient answer would be to adopt a multi-level governance framework between supranational, national, and local levels of the exercise of powers.<sup>153</sup>

<sup>151</sup> Breuss & Eller, *supra* note 136, at 44, sum up this insight stating, “[i]n case of too much decentralisation inter-jurisdictional externalities cannot be internalised and economies of scale are not realised; negative growth effects are the consequence. The same holds for a low level of decentralisation: unconsidered preferences lead to inefficiencies in the provision of public goods, what inhibits, in turn, economic growth.”

<sup>152</sup> On the concept of multi-tier governance, see Inman & Rubinfeld, *supra* note 58, at 44 (“those who value a federal system [multi-tier governance] typically do so for some mix of three reasons: it encourages an *efficient* allocation of national resources; it fosters *political participation* and a sense of the democratic community; and it helps to protect basic *liberties and freedoms*.”).

<sup>153</sup> See generally Liesbeth Hooghe & Gary Marks, *Unraveling the Central State, But How? Types of Multi-Level Governance*, 97 AM. POL. SCI. REV. 233 (2003).