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# The Legal Innovation of the European Grouping of Territorial Cooperation and its Impact on Systems Competition

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**Abstract**

The European Grouping of Territorial Cooperation (EGTC) is a novel European legal form for cross-border, interregional and transnational cooperation. It was first implemented in 2006. It allows the cooperation of regional authorities, associations or other public bodies to form an own legal entity. To explain the mechanisms behind a legal innovation such as the EGTC, we apply insights from innovation economics, political sciences, and Law and Economics to the generation and diffusion of legal innovations. The EGTC has been generated by the EU actors in a top-down process of statutory legal innovation. Although it is a rather new legal form, with a database still too narrow to perform quantitative tests, our analysis shows that both internal determinants and regional diffusion models are useful in explaining the adoption of the EGTC. Since the EGTC changes the opportunities for cooperation within systems competition, it may act as a driver of further legal evolution, bringing about bottom-up legal innovation. By applying the four notions of systems competition, we find that the EGTC as a legal innovation may improve both yardstick and locational competition. So far however, there is no clear evidence that it also impacts regulatory competition in its narrow sense or competition among different legal arrangements.

**Keywords:** European Integration, Law and Economics, Systems Competition, Public Corporate Law, Innovation Economics

**JEL Classification:** F15; K20; H70; O31

## 1. Introduction

Cross-border and interregional cooperation in Europe has been an interesting 'incubator' for legal innovation ever since the very start of European integration after World War II. Already in the 1950's different forms of territorial cooperation evolved. These different kinds of cooperation had used a broad range of diverse legal forms, constituting bottom-up legal innovations. Later on, top-down legal innovations originated from both the Council of Europe and the European Union. Following some minor initiatives, in 2006 the EU implemented the European Grouping of Territorial Cooperation (EGTC), a legal form that already t in 2013 has been substantially modified.

The EGTC is a novel European legal instrument designed to facilitate and promote cross-border, transnational and interregional cooperation. The EGTC is a legal entity and is meant to enable regional and local authorities and other public bodies from different member states to set up cooperation groupings with a legal personality. It is unique in the sense that it enables public authorities of various Member States to team up and produce joint services without requiring prior international agreements to be signed and ratified by national parliaments.

To explain the mechanisms behind a legal innovation such as the EGTC, in this paper we apply insights from innovation economics, political sciences, and Law and Economics to the generation and diffusion of legal innovations. In addition, we sketch out how systems competition acts as a main driver of further legal evolution. Finally, we employ our approach on the EGTC and its evolution.

Accordingly, the paper is structured as follows. Section 2 lays the theoretical foundation for analysing legal innovation with a special focus on its interdependence with systems competition. Section 3 applies this approach to the development of territorial cooperation in Europe. After presenting the main features of the EGTC, we depict its evolution as a top-down supranational legal innovation and inquire after the interrelationship with systems competition. Section 4 summarizes and concludes.

## 2. Legal Innovation and Systems Competition – the Theoretical Background

### 2.1 Innovation Economics

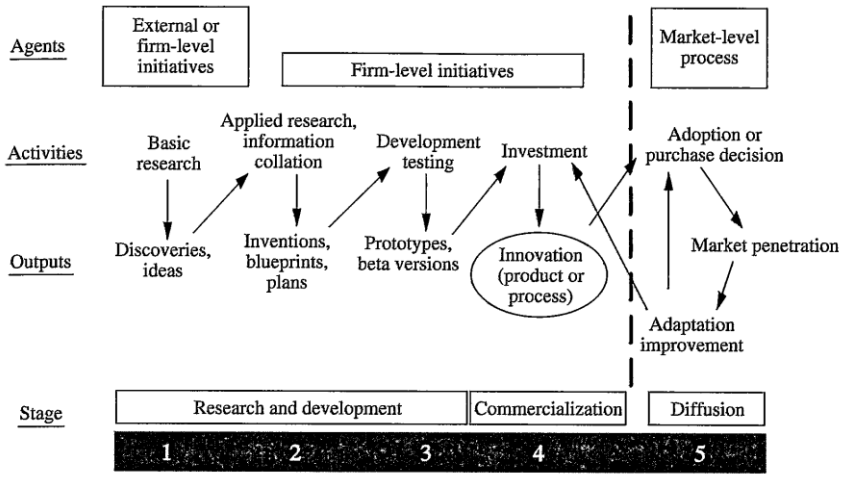
Explaining the generation and diffusion of innovations is strongly related to the work of Joseph Schumpeter (1912; 1942). For him, innovation is at the heart of modern capitalist market economies. Competition sets incentives for companies to bring about a hitherto unseen number of new products and services, furthering the dynamics of technological change and market evolution. In its broadest sense, an innovation is perceived as a new way of doing things by re-combining existing and well-known action possibilities as well as by generating novel ones. It always entails the generation and application of (new) knowledge.

There are a number of typologies trying to classify relevant aspects related to innovation activities. Innovation economics distinguishes between *process* or *product innovations*, depending on whether the focus is on new technologies which are used for producing goods and services or on new products themselves which increase the variety in existing product markets or even create totally new markets. In addition, *organizational innovations* and *marketing innovations* are distinguished (OECD/Eurostat 2005, 17, 47ff.). When it comes to the *degree of novelty* embedded in an innovation, innovations can be classified as being of a radical novel kind or of displaying just a gradual novel character when compared to existing varieties. In addition concerning the *addressee* of an innovation, one distinguishes whether an innovation is new to the firm, new to the market or new to the world (OECD/Eurostat 2005, 57f.).

In regard to *the process of generating innovations*, one differentiates between invention and innovation. Invention refers to the generation of new ideas and knowledge, mainly carried out by basic research. Innovation characterizes the application of these new ideas and novel knowledge by generating new technologies, products or services which are then commercialized.

To further analyze this process, a *multi-stage concept* is applied (Figure 1). Despite the linear nature in which it is usually depicted, it is now widely accepted that there are a number of feedback loops linking the activities from the different stages to one another. This concept can much better represent the complex interactive nature of innovation processes.

Figure 1: The Stages of the Innovation Process




Source: Greenhalgh/Rogers (2010, p.7, Figure 1.1)

The concept of "National Innovation Systems" allows to capture the *systemic nature* of the process of generating and disseminating innovations in more detail (for definitions, see OECD 1997, 10. Box 1). It "(...) essentially consists of three sectors: industry, universities, and the government, with each sector interacting with the others, while at the same time playing its own role" (Goto 2000, 104). It helps to more clearly identify the different actors and drivers involved in economic or technological evolution that is, the ongoing path-dependent modification of innovations over time. Thus, it also allows to better target innovation related policies and their potential direct and indirect effects.

As *drivers of innovations* both demand and supply side factors are identified. Differences in firms' capabilities to carry out innovation related activities are essential in explaining the differential success of firms in generating and imitating innovations. Appropriability of the revenues generated by innovations is a main determinant, which relies only to some extent on formal institutions, but also on the absorptive capacity of firms. Formal institutions such as intellectual property rights help firms to internalize the value of innovations by protecting them from spillovers being exploited by competitors. The absorptive capacity is determined by the internal skills and capabilities that are stored in the organizational routines of firms to cope with the challenges posed by generating innovations (Teece 2007).

The adoption of innovations within a market is generally modelled as a *diffusion process* which follows an S-shaped curve. Usually, there is only a small percentage of early adopters, followed by an increasing number of users over time, with market saturation characterizing the

final stage of this cumulative process. While epidemic models rely on a stochastic process to explain this S-shaped curve - with innovators and potential adopters meeting by chance, rank models look at the very factors that explain in more detail the reasons for adopting innovations by firms when costs and thus prices of the innovation decrease over time (Stoneman 2002).

Generally, the diffusion process is characterizes as follows (Galagher/Rogers, 2010, 176ff.): Before any firm or consumer decides on whether and when to adopt an innovation, information about it must be available to him or her. The decision to adopt depends on a number of factors, such as (1) the risk attitude of consumers or firms in case of totally novel products or services, (2) the price of the innovation, which usually decreases due to an increase in market share, (3) its quality and performance, which also improves over time in case of novel technologies whose potential is not completely exploited right from the start of the diffusion process. During its course an industry life cycle arises. In the beginning the number of firms grow, since newcomers enter the market by imitating a successful innovation. Accordingly, while in the early stages of diffusion, the pioneering entrepreneur holds a monopoly, market pressure increases with a growing number of competitors entering the market, leading to additional incentives to lower prices and/or improve quality.

For evaluating the welfare properties of innovations, in a dynamic setting there is no absolute criterion. Since there are a number of potential market failures at work, even a commercially successful innovation cannot be said to be the best one, given a whatsoever absolute standard. An innovation always entails novel knowledge which displays public goods characteristics and positive externalities, respectively. In addition, as stated above, information imperfections impede the adoption of innovations, while network effects and lock-ins might arise due to economies of scale and scope. Moreover, the wealth effects arising from innovations set a permanent process of feedbacks going with an endogenous generation of further innovations and their modifications. Thus, economic change can best be characterized as an evolutionary process that is fueled by competition. As long as competition is workable, its monitoring, knowledge-creating and innovation-inducing effects are present, as stated in section 2.4 below.

## 2.2 Policy Innovation and Diffusion

In the political sciences, there is a strand of literature on policy innovation and diffusion which draws on the main concepts of innovation economics and distinguishes between policy invention and policy innovation. The former is analysed as the generation of fundamentally new policies, whereas the latter is perceived as a policy that is new only for a certain jurisdiction adopting it, while it is already implemented in another jurisdiction (Berry/Berry 1999, 223).

There are two main approaches that explain the factors affecting the adoption and thus diffusion of policy innovations: internal determinants models and diffusion models (for an overview see Berry/Berry 1999). Internal determinants models see institutional, political, economic and societal characteristics of the respective jurisdiction as the decisive factors which account for their adoption. In contrast, diffusion models highlight the impact of other jurisdictions which already have adopted a certain policy innovation.

Internal determinants models allow to identify the main drivers and obstacles for policy adoption which are inherent to a particular jurisdiction. According to this approach, adopting policy innovations mainly depend on the following factors: (1) whether policy-makers are satisfied with the status quo or whether there is a problem perceived as a 'crisis' for a certain policy field for which changing collective policy solutions are required, (2) whether there are resources available for implementing a new policy (be it financial, administrative or human capital resources), (3) whether the absorptive capacity for policy adoption exists that is, experiences and infrastructure for implementing new policies (see Grinstein-Weiss/Wagner/Edwards 2005, 3ff.)

There is a variety of diffusion models: *Regional diffusion models* look at the impact of other jurisdictions for policy adoption, emphasizing geographical, political and cultural proximity. *National interaction models* stress the interaction among policy actors from different jurisdictions as a means of disseminating information about successful policy alternatives. *Vertical influence models* see as the main explanatory factors incentives set by pressure or fiscal incentives exerted from higher jurisdictions to which lower level jurisdiction tend to comply with (Berry/Berry 1999).

### 2.3 Legal Innovation and Diffusion

In explaining legal innovations and their diffusion there is a broad literature using insights from innovation economics while also combining approaches from new institutional economics, law and economics, and public choice, resp. new political economy (Eckardt 2011, Dötsch/Okruch 2014).

The law can be conceptualized as a *socio-technological arrangement* which governs social interactions. It eases cooperation and reduces or solves conflicts by assigning rights for certain actions to certain individuals. These rights concern either individual actions (see private property rights or liability law) or multilateral transactions (see contract law). In addition, the law also provides legal rules to create a legal personality for certain types of organizations (see corporate law). This is the prerequisite for firms, for example, to carry out actions or transactions on their own. Furthermore, the law assigns entitlements or claims to persons against others (see family law, social security law or tax law). In addition, it states procedural rights which define how rights are enforced. (Eckardt 2001, 10ff.)

What exactly defines a *legal innovation* depends on the question(s) addressed. Of interest might be a single legal rule, like the strict liability rule in tort law, or a bundle of legal rules, like those constituting private property or a corporate legal form, like the EGTC as to which our case study refers to. A legal innovation can be defined as a re-combination of the different elements of a right (that is, the facts it applies to, the rule(s) which it entails, the burden of proof associated with it, etc.).

Legal innovations also differ according to the *degree of novelty* they include. A legal innovation – be it a single rule or a bundle of rights – might be totally novel so that it can be called a radical legal innovation, but it might also show only a gradual modification of an already existing rule or bundle of rules. In addition, concerning the *addressee* of a legal innovation, it might by new to the world, new to a particular jurisdiction or new to the addressees it applies to or who adopt it.

One can also distinguish *different phases in the process of legal change*: invention, innovation and diffusion by adopting legal innovations by different actors (be it persons, firms or jurisdictions, depending on the respective research question). A *legal invention* refers to the creation of new knowledge and ideas, which – like in the case of technological inventions – can be

said to result from basic research by legal science. *Legal innovations* then concern the application of such novel ideas. They are generated through two profoundly different mechanisms. A *statutory legal innovation* results from deliberate collective actions by a legislative body, leading to the enactment of a novel statute. In contrast, a *judge-made legal innovation* is the potential outcome from adjudicating law by the judiciary – being either an intended, or – which is more often the case – an unintended effect when judges decide in court. There are profound differences in how these two types of legal innovations are generated. Statutory legal innovations are the result of the 'normal' working of legislative bodies whose very purpose it is to create novel legal rules. For a statutory legal innovation to happen some collective action has to take place. This rests on a commonly perceived problem and then on its success in competing with other issues on the political agenda, before a new statute is passed and finally implemented. For a judicial legal innovation to be generated, the minimum requirement is that some issue is contested at the courts. For this, at least one plaintiff has to go to court because he or she perceives that his or her rights have been violated and thus have to be enforced by the judiciary. As a consequence, a process of judge-made legal change might be put in motion. In this course, a judge-made legal innovation arises whenever novel matters have to be decided for the first time in court or whenever existing legal rules are interpreted in a novel way by the courts. Thus, judge-made legal innovations might be the unintended outcome of going to court since the 'normal' working of the court system is to adjudicate existing law. Therefore statutory legal innovations are the result of a *top-down process* of generating legal innovations, while judge-made legal innovations are the result of a *bottom-up process* since it usually involves a legal case to pass through the hierarchical court system from the lower courts to the higher/highest court(s) (for more on this see Eckardt 2011, Dötsch/ Okruch 2014).

The relative importance of statutory vs. judge-made legal innovations depends on the respective national legal system. Generally speaking, statutory legal innovations play a decisive role in civil law systems, while judge-made legal innovations are of more importance in common law systems. However, in modern democracies there are no legal systems where only one mechanism is at work. The notion of a *(Supra-)National System of Legal Innovation* allows one to better capture the *systemic nature* of the different actors involved in generating and disseminating legal innovations (Eckardt forthcoming). It comprises all actors/organizations

and the underlying institutions that are involved in the process of generating and disseminating legal innovations. Its main elements are (1) the political system bringing about statutory legal innovation; (2) the court system delivering judge-made legal innovation; (3) the executive branch (administration), which applies statutes and by this potentially changes the way they are implemented; (4) the wider society, including in particular the economy in generating demand for both statutory and judge-made legal innovations resulting from the wealth incentives set by the law, and (5) the jurisprudence/legal sciences as a main intermediary for legal invention and innovation. Together they interact both on the demand and supply side in creating legal innovations and modifying existing legal rules.

In addition, generating legal innovations is not confined to the national state. In the EU, for example, legal innovations are also generated at the supranational level by the EU institutions. One can distinguish between *supranational statutory legal innovations* made by the relevant actors at the EU level (European Parliament, Council, indirectly also the Commission) and *supranational judge-made legal innovations* created by the European Court of Justice. Again, supranational legal innovations constitute a top-down process while supranational judge-made legal innovations are the result of a bottom-up process of legal change.

For analyzing the *diffusion of a legal innovation* one has to take into account its specific characteristics. For example, there are legal innovations that – in principle – apply to all addressees from the moment of their enactment. In this case, the diffusion of such a legal innovation can thought of being binary with an adoption rate of 0% as long as it is not enacted and with an adoption rate of 100% as soon as it is enacted. This holds for example for tax law or social security law innovations which are compulsory for all addressees.[1]

Compared to that, there are other types of legal innovations for which the diffusion process is not binary, but can be modelled according to the S-shaped curve discussed above for the diffusion of economic innovations. This holds for example for judge-made legal innovations which only apply if someone goes to court and acts on them (Eckardt 2011).In addition, it also holds for legal innovations which are not compulsory, but increase the available legal options for relevant addressees. An example of this are new legal forms like the EGTC which add an additional variant to the already existing options for legal forms for cooperation.

[1] Note that also in these cases the adoption rate of a legal innovation might be less than 100% due to lack of resources or administrative capacity, for example, which impede its proper implementation or enforcement.

For these types of legal innovations, some of the main insights from economic and policy diffusion models can be applied. Information about the availability of a legal innovation is a necessary, but not sufficient condition to explain its adoption. Both the incentive structure of the potential adopters and their absorptive capacity are further determinants which influence the decision to adopt a legal innovation. Following the internal determinants model of policy diffusion, (dis-)satisfaction with the status quo, resources available for implementing a new legal variant (be it financial, administrative or human capital resources) and the necessary infrastructure and experiences for implementing legal innovations are crucial. The rate of adoption also plays a role, and the proximity to those that already have adopted this legal innovation has an impact, too. The probability to adopt a legal innovation should increase with geographic, political and cultural proximity to early adopters. As a consequence, an S-shaped diffusion curve can be hypothesized also to prevail for the dissemination of such legal innovations.

When it comes to evaluating the welfare properties of legal innovations, the same applies as is stated in section 2.1 with respect to economic innovations. Legal innovations are also characterized by public good characteristics, externalities, information imperfections, economies of scale and scope and network effects, *inter alia*. Even when conceptualizing the generation of legal innovations along the lines of neoclassical markets, thus, no clear-cut assessment is possible. This holds although there is a strong strand of normative literature arguing that judge-made legal innovations should be efficient (that is welfare-maximizing), while statutory legal innovations should be rather inefficient (and thus not welfare-maximizing) due to the strong rent-seeing incentives at work in the political system. But on the one hand this kind of argument assumes that the drivers for going to court always act along welfare increasing lines or otherwise poses strong information requirements on judges, which are not met in reality. On the other hand it denies more or less the possibility that legislative bodies can learn and generate welfare enhancing statutory innovations.

### 2.4 Systems Competition and Legal Evolution

Profit- as well as rent-seeking motives are the main drivers for generating and disseminating innovations in modern societies. To explore in a more systematic way what drives legal inno-

vations and their diffusion, in the following we supplement the concept of the (Supra-)National System of Legal Innovations outlined above with the notion of systems competition.[2] In this way additional insights are gained on how legal innovations impact the incentive structure of the actors in the economy. This in turn results in feedback effects, thus setting a permanent process of legal evolution in motion.

For competition to work and to align the preferences of the demand side with the offerings from the supply side, there must be scope on the side of consumers to decide against the supply offered by producers. Thus, in economic markets, consumers are free to choose from which producer to purchase. If consumers are not content with one producer they can switch to others. Accordingly they signal with their purchasing power what supply they prefer. Systems competition can also be analyzed along such lines.

Systems competition (or synonymously, institutional or interjurisdictional competition)[3] means the different forms of competition among governments. In analogy to competition in markets, governments are modelled as the management bodies of their jurisdictions. While managers in a firm decide on the bundle of goods the company is to produce and to supply, governments are seen as entitled to choose the bundle of *common goods* within their jurisdictions, e.g. governments decide on which public goods and services are to be produced as well as on the ways of financing their production. Such common goods always require the enactment of statutes or other legal instruments. Accordingly, offering novel common goods is bound to generating statutory legal innovations.

Common goods are to be understood in the broadest sense. They comprise physical infrastructure and services like education, transport, health care etc., but also – and equally important – the institutional infrastructure of the economy. The formal institutions the government does supply may contain constraints of different degrees of generality, i.e. both universal rules in accordance with the Rule of Law as well as specific regulations. Governments may even resort to downright discriminatory institutions like special privileges for a narrowly defined group of beneficiaries, although those discriminatory rules should be minimized by (constitutional) meta-rules reflecting the Rule of Law. In the absence of any kind of systems

[2] Our focus on systems competition does not mean that there are no other drivers of legal innovation at work. With respect to the co-evolution of technology and law, see for example Eckardt (2001; 2004; 2011).

[3] Compare as basic contributions e.g. Dye (1990); Vihanto (1992); Vanberg/Kerber (1994); Kerber/Vanberg (1995); Sinn (2003).

competition a democratic government can act as a natural monopolist, although constrained by the Rule of Law and contested by sequential political competition, i.e. the threat of political newcomers at the time of the next general elections. Though there may be efficiency arguments for such a temporal territorial monopoly, it is far from clear that the common goods supplied by a purely monopolistic government meet the crucial normative standards, i.e. the constituents' preferences for such common goods.

Once systems competition is present, the beneficial effects of competition in markets (given appropriate institutions) can also be expected in politics: (1) the monitoring function – competition should realign public supply and the public's preferences and avoid discriminatory actions; (2) the innovation function – like private companies governments may, under competitive pressure, engage in innovative activities; and finally (3) the knowledge creating function – competition is generating the knowledge about the citizens' preferences, not only at a given moment, but constantly via the ongoing process of trial-and-error that innovative activities constitute.

Systems competition may work either vertically or horizontally. *Vertical systems competition* means the hierarchy of jurisdictions in federal political systems, but also in the context of the European Union vis-à-vis its member states. *Horizontal systems competition* works among jurisdiction on an identical level, i.e. among regions, national states, or even different supranational entities.

By differentiating between different factors that are mobile between jurisdictions, four types of interjurisdictional competition can be distinguished (Kerber 2000).

The first type is characterized by autarky, i.e. jurisdictions are economically isolated. Only information about the (relative) performance of countries is mobile, i.e. *Yardstick competition* is possible (Breton 1996, 233f.). Governments can observe the workability of other countries' (or regions') policies and institutional arrangements. Governments may imitate or adopt successful policies and institutions from other jurisdictions, or they may try to further develop the foreign solution and to find even superior political innovations. But governments may also decide to block the mobility of information in order to avoid that citizens compare the performance of foreign societies and economies to the domestic performance. In the case of legal innovations there is a scientific kind of Yardstick competition, as it is the very task of Comparative Law to observe foreign legislation and adjudication, and to assess their effects. The

(perceived) superiority of foreign institutions might lead to policy advice for domestic adaptation or even to a 'legal transplant'.

The second type of systems competition is given when goods and services are mobile. Since institutions in the country of origin influence the price and especially the quality of the tradable goods, an indirect form of interjurisdictional competition, namely *regulatory competition*, takes place. A straightforward way to escape this kind of competitive pressure on domestic companies is lobbying for protectionism. However, this openly protectionist option has been removed early in the process of European integration. A more subtle kind of protectionism are national standards of production that indirectly influence prices and quality. But since the invention of the Cassis de Dijon-doctrine by the ECJ (a judge-made legal innovation in itself) the leeway for those "measures having an effect equivalent to quantitative restrictions on imports" (cf. Art. 34 TFEU) has been heavily restricted.

Consequently, within the EU the country of destination cannot ban the import of cheaper products or of products with higher quality. The domestic producer in the EU country of origin, unable to lobby for direct or indirect protectionism, may only put political pressure on the government to change domestic regulations that cause a reverse discrimination. It is not clear whether such lobbying activities lead to success and to domestic deregulation via institutional adaptation. It is even more unclear how to evaluate the consequences of systems competition: competitive pressure on governments may induce a 'race to the bottom', but it may as well open the opportunity to innovative and smarter ways of regulation.

The third type of systems competition is *locational competition*, which is no longer an indirect, but a direct mode of operation. When individuals, factors of production, and companies are mobile between jurisdictions, locations compete directly, as towns, regions, or states attempt to attract those mobile factors. With this kind of locational competition, governments lose their temporary monopoly, because citizens cannot only permanently assess the bundle of institutions, regulations, taxes and common goods provided by the domestic government, but they may also credibly thread to leave the country if they deem a foreign bundle to be superior. That is to say that with locational competition governments also lose the territorial control of the monopoly for the provision of bundles of common goods (and the power to tax), since citizens may not only express political or judicial protest (*voice*), but may 'vote by feet' as well, i.e. *exit* the jurisdiction (Hirschman 1970).

Finally, a fourth type of systems competition may be effective if formal institutions are internationally mobile, leading to *free choice of law* from jurisdictions. While this kind of systems competition might be very intense, since no transport costs are induced, the possible fields of application are probably limited. A widespread mobility of this kind would mean that the legal principle of territoriality is questioned. A prominent example within the EU is the free choice of private corporate law, effective both horizontally (among member states) and vertically (between national corporate law and European legal forms, like the SE) (Kerber/Eckardt 2014).

As this short outline shows, systems competition is one of the mechanisms within which legal innovations, by which novel common goods are supplied, take place. Given the response of citizens to the provided common goods through these four types of systems competition, incentives are set for changing the bundle of common goods offered. These in turn lead to modifications of existing legal rules or to the creation of new legal rules for their provision. Thus, a permanent process of legal evolution is set in motion, with systems competition as one of the driving forces.

## 3. The EGTC as a Legal Innovation

### 3.1 The Institutional Design of the EGTC

The EGTC is a novel European legal instrument designed to facilitate and promote cross-border, transnational and interregional cooperation. The EGTC is a legal entity and is meant to enable regional and local authorities and other public bodies from different member states to set up cooperation groupings with a legal personality, thus supplying common goods in a cross-border manner.

From an Law and Economics point of view, public as well as private enterprises can be seen as a nexus of incomplete contracts, both explicit and implicit ones (Kraakman et al. 2009; Schaper 2012; Eckardt 2012).[4] To gain from team production the different stakeholders involved in an enterprise pool their resources. Due to the contingencies and uncertainties of the future, it is not possible to write ex ante complete contracts which deal with all possible future events. A legal form provides a partly institutionalized governance mechanism for a joint undertaking by delineating the overlapping action spaces of the stakeholders involved.

[4] This section draws on Eckardt/Gritsch (2016).

It eases cooperation among the different resource owners by securing their ownership rights through assigning well-defined property rights and decision rights. Besides, it reduces information problems, in particular those resulting from asymmetric information and principal-agent relationships by stating information rights and disclosure duties as well as rules in regard to decision-making. In addition, legal form reduces transaction costs by providing procedural rights and conflict resolution mechanisms. In case of international cooperation, coordination rules, stating the law applicable, also reduce uncertainties. This holds also in case of cooperation among public entities. The EGTC provides a supranational legal form for establishing an enterprise formed by public entities from different member and non-member states.

Regulation (EC) No 1082/2006 of the European Parliament and of the Council, accepted on the 5th July 2006 is the legal core of EGTCs (European Union 2006). In 2013, several amendments to this regulation were introduced by Regulation (EU) No 1302/2013, accepted on the 17th December 2013. The main objectives behind this amendment are "clarification, simplification and improvement of the establishment and functioning of such groupings" (European Union 2013). Article 1 cif.2 states the main objective of an EGTC is "to promote in particular territorial cooperation … with the aim of strengthening economic, social and territorial cohesion". To this end, it is granted legal personality (art.1 cif.3).

To establish an EGTC, members must come from at least two EU member states, or one member state and at least one third country (or overseas territory) member, where the third country shares at least one joint border with one of the countries of the EGTC's members (art.3 cif.2, art. 3a). Members of an EGTC can be public entities from different levels: member states, national, regional or local authorities, public undertakings. Private undertakings which are owned by public entities and carry out operations of general economic interest are also eligible for membership (art.3 cif.1). Since the EGTC has its own legal personality, it can have an own budget (art.11), can hire its own human resources, and can sign contracts independent from its members (art.1 cif.4). Its tasks are defined by its members in conformity with the Regulation and in conformity with the competence granted to each member of an EGTC under its respective national law (art.7). Thus, member states still have a say in the competences granted to public entities which are members of an EGTC. Regulation (EU) No 1302/2013 explicitly states that carrying out programmes supported by EU funds are not the only tasks EGTCs could be concerned with, thus taking a broader approach than under Regulation (EC)

No 1082/2006. However, member states are free to limit the involvement of their members in other tasks (art.7 cif.3). Since an EGTC has its own legal personality and is allowed to conclude contracts and enter into liabilities, art.12 deals with liability issues, both of the EGTC as well as of its members. For example, if one or more of these are of limited liability, this must also be stated in the name of the respective EGTC. Besides, member states are free to prohibit registration of limited liability EGTCs on their territory. In addition, any member state can require appropriate insurance or guarantees from limited liability EGTCs.

These principles are laid down inter alia in the convention of an EGTC, which must be accepted unanimously by its members (art.8). In addition, it specifies its name, location of registered office, objectives and tasks as well as duration. It contains a list of its members, its organs and their competences. Besides, it states the applicable Union and national laws and the provisions for adopting and modifying its statutes. The statue of an EGTC deals with the provisions necessary for an effective working of the EGTC, like organs, the representatives of the members in the EGTC, the decision-making procedures, its working language(s), procedures for personnel management and recruitment as well as financial contributions by members (art.9). Art.10 states the minimum organizational framework of an EGTC, which is composed by an assembly of its members and a director acting in the name of the EGTC. Additional organs and their competences, like an advisory board, can be laid down in its statutes. Besides, the statue should contain provisions for carrying out the tasks laid down in the convention, in particular with respect to personnel management, financial contributions and budgeting and accounting rules. For financing the tasks of an EGTC, an annual budget has to be established including provisions of running and operational costs (art.11).

Art.4 provides rules for establishing an EGTC. After having reached unanimous consensus on the topics to be laid down in the convention and statute, prospective members have to notify the member state where they are located. Each member state grants approval to the convention for its national members, unless the documents do not conform to the EGTC Regulation, Union law or national law of the respective member state or is in contradiction to the public interest. In these cases modifications may be demanded. With the 2013 Regulation the notification period was extended to six months (in contrast to a three month period before), with the provision of tacit agreement if no objections are raised within this period. This rule, however, does not apply to the member state, where the EGTC should have its registered office. In this case, explicit approval for establishing an EGTC is necessary. Since the member

state where an EGTC is officially located, provides the applicable law for a number of topics, this is a useful provision. After its successful approval, the EGTC has to ensure that its establishment is announced in the Official Journal of the European Union to finally gain legal personality (art.5).

Although the EGTC is a supranational legal form, member states still have a lot of say in regard to its setting up and operating. This holds in particular for the member state where an EGTC has its registered seat (art.2). Member states have to implement procedures for the working of EGTCs with a registered seat under their jurisdiction. They are also responsible for controlling the management of public funds (art.6). Besides, member states might prohibit any activity of an EGTC on its territory, if this endangers its "provisions on public policy, public security, public health or public morality" (art.13). A member state is also free to prohibit the registration of EGTCs with limited liability on its territory (art.12). In case of conflicts, Union legislation should apply before the courts of the member state where the registered office is (art.15). In addition, EGTCs should not impede citizens' national constitutional rights against public entities which are members of an EGTC (art.15 cif.3).

All in all, the EGTC Regulations seem to provide a workable framework for setting up a legal form for public entities from different member and non-member states with its own legal personality to provide common goods to their citizens.

### 3.2 The Evolution of the EGTC

One basic challenge behind territorial cooperation is the incongruence of political territory on the one hand and the geographical range of a 'problem' that needs collective action on the other. In other words, there is no "perfect mapping" (Breton 1965) that would match regional needs and preferences for common goods with the production of such common goods. Plausibly, this holds especially for border regions. Against this backdrop it has been observed that "European integration has had a dual impact on border regions. On the one hand, borders were physically dismantled across most of the EU's territory (…). On the other hand, border regions have become a fertile ground for territorial cooperation and institutional innovation" (de Sousa 2013, 669). European integration eases the beneficial collective action among regions, but also reveals the lasting difficulties for cooperation that require institutional innovations.

The history of territorial cooperation in Europe after WWII can indeed be read as a sequence of institutional (and partly legal) innovations, both from bottom-up and top-down. Bottom-up institutional innovations stem from the various actors of cross-border, interregional, or transnational cooperation in search for appropriate forms of governance. Top-down institutional/legal innovations originate from both the Council of Europe and the European Union. Obviously, these two mechanisms of creating legal innovations are interdependent. Basically, all legal initiatives of the EU or the Council of Europe are designed to solve governance issues that are difficult to be managed by decentral actors.

The history of post-war territorial cooperation among contiguous regions started as early as in 1958 with the first Dutch-German *Euroregion*.[5] From the beginning, there has been a search for the appropriate legal form of such cross-border cooperation – spanning from purely informal agreements to mostly registered associations in accordance with the law of one of the participating regions' country (Zapletal 2010, 18). The decentral bottom-up search for such legal innovations was first accompanied by establishing the Association of European Border Regions in 1971 that acted as an "institutional entrepreneur" (Perkmann 2003, 168), mobilizing attention to and increasing political awareness for the specific needs of border regions Despite this political support and although the number of cross-border cooperation continued to grow, the fundamental governance issue remained unsolved.

In 1980 an important initiative to address this issue was taken by the Council of Europe resulting in the "European Outline Convention on Transfrontier Co-operation between Territorial Communities or Authorities" (Council of Europe 1980). This *Madrid Convention* sought to promote cross-border cooperation by providing model agreements. However, it turned out to be at best a partial solution. The application of the Madrid Convention was impaired by its construction that bi- or multilateral international contracts were a necessary precondition. Some of the subsequent international contracts contain a more general applicable legal form, namely the *Local Grouping of Cross-Border Cooperation* (LGCC). But since this legal form can only be used by the regional bodies of the contracting parties, LGCCs could not serve as a general solution to the governance problems of territorial cooperation (Engl 2016, 146).

[5] Interregional (non-contiguous) co-operation started with twinned towns; the earliest initiative for transnational co-operation was the Nordic Council, starting in 1952.

In contrast to the legal innovations by the Council of Europe, the EU supported territorial co-operation primarily financially. Although the establishment of the Committee of the Regions in 1994 gave also more political importance to the regional level, it was from 1990 on the INTERREG program that led to an increased interest from the regions in territorial cooperation due the massive financial support it provided. But exactly the management of those EU-funds in a transnational context made the unsolved governance issues obvious and urging (Sousa 2013, 670).

It may be surprising how long it took until the EU tackled this institutional/legal issue, although the obvious success of INTERREG supported the trend towards a 'New Regionalism' in Europe and helped the EU diversifying the European multi-level governance system. Since from a Public Choice perspective strengthening the regional level (and thereby bypassing the member states) is in the interest of the supranational level, it could have been expected that the EU would be much quicker in breaking down barriers to even more effective support of the regions.

After some earlier (and basically fruitless) attempts to establish European legal forms, finally in 2006 the first draft of what later on became the EGTC was presented. Vis-à-vis the EU-practice of financial support, this initiative was a real legal innovation: "The Regulation triggered a lively debate, since the EU was for the first time 'legislating' on the governance and legal structures of regional policy, rather than on usual (and important) business such as the provision of a multi-annual plan and financial framework" (Spinaci/Vara-Arribas 2009, 6).

Thus, the EGTC as a supranational statutory legal innovation is the outcome of a top-down process. However, this does not mean that its diffusion is a binary 0/1 process. For it to be implemented at the national level, provisions for implementing it have to be enacted by each EU member state separately. In federal states subnational units like the *Länder* in Germany are the competent authorities for doing this. Designing and enacting such provisions needs time and resources. For example in regard to the EGTC Regulation (EC) No 1082/2006, the Land Berlin/Germany was an early adopter, by implementing the respective provisions in February 2007, while the Burgenland/Austria was a late adopter with enacting it in April 2011 (Pucher/Hauder 2016, Annex 1). Amendments for adopting Regulation (EU) No 1302/2013, which modifies the EGTC in some respect, have still not been made in all Member States. At

the end of 2016 only 36% of the competent authorities have enacted the necessary provisions (Zillmer et al. 2017, 12-14 and Annex 1).

While implementation of the Regulation at the national level is a necessary prerequisite, it is not sufficient for adoption of the EGTC as a legal form by prospective addressees. For this to happen, information must be available on the existence and the potential usefulness of this new legal form to better enable cross-border cooperation than other already existing legal forms would allow. Meanwhile both the Committee of the Regions and national authorities host websites where they make information available to the prospective adopters at low costs or organize other forms of awareness raising events (Zillmer et al. 2017, 14-16).[6]

65 EGTCs have been founded since 2008, which is on average 7 new EGTCs per year (Zillmer et al. 2017, Table 3, 113). Their main fields of activity are tourism, culture and sports, transport and infrastructure, education and training and entrepreneurship and regional development. Most EGTCs state a rather broad purpose for their activities, only very few are founded to follow a special purposes, like the EGTC *Hospital de Cerdanya*. It was founded in 2010 by French and Spanish public bodies to operate a hospital on a cross-border basis (Zillmer et al. 2017, 120f.). EGTCs also participate in ETC programmes – which had been the original idea behind creating this legal form, although there are quite a number of obstacles and challenges to overcome (Zillmer et al. 2017, 121ff.).

Table 1 shows the number of newly founded EGTCS by year, the yearly growth rates and the accumulated number of members of the newly found EGTCs.

*Table 1:* Newly Founded EGTCs and Number of Members, 2008 - 2016

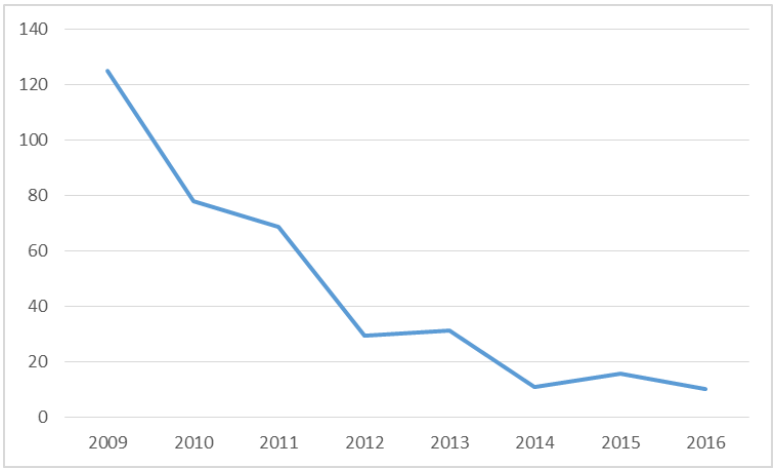
| Year | EGTC | Growth p.a. | Members |
|---|---|---|---|
| 2008 | 4 | | 98 |
| 2009 | 5 | 125% | 220 |
| 2010 | 7 | 78% | 220 |
| 2011 | 11 | 69% | 107 |
| 2012 | 8 | 30% | 177 |
| 2013 | 11 | 31% | 38 |
| 2014 | 5 | 11% | 32 |
| 2015 | 8 | 16% | 37 |
| 2016 | 6 | 10% | n.a |

Source: Own Calculation according to Zillmer et al. (2017, Figure 1, 112).

[6] See for example the information provided on the following websites http://cor.europa.eu/de/activities/networks/Pages/egtc.aspx and https://portal.cor.europa.eu/egtc (last access 26/10/2017).

Figure 2 shows a continuing decline in growth rates. To draw the conclusion that this is already a sign for saturation in adopting EGTCs within the EU member states, however, seems to be too early. Since the EGTC is a rather complex and costly legal form, there is still a lot of experimentation going on for which fields of activity it provides the appropriate legal frame for cross-border cooperation. This also shows in the modifications that have been adopted in its Regulation in 2013. At the end of 2016 there were 23 EGTCs under constitution awaiting approval (Zillmer et al. 2017, 128), indicating that there is still demand for adopting the EGTC.

Figure 2: Growth Rate of EGTCs (in %)




Source: Own composition based on Table 1.

In accordance with insights from innovation economics, the *Internal determinants model of policy diffusion* stated that absorptive capacity is of utmost importance for implementing an innovation. This holds also in regard to the EGTC as a novel legal form. There must be at least some resources available on the regional level for introducing this legal form since its very establishment itself results from a time-consuming process occupying a number of qualified personnel. In addition there are annual reporting requirements, which also require resources available for meeting them.[7] All in all, this reasoning shows that after establishing an EGTC its performance also depends on the resources available, thus the internal determinants model might be of use in guiding future empirical work.

*Regional diffusion models* suppose that geographic, cultural and political proximity plays a decisive role in the decision of actors to adopt an innovation. As regards the regional distribution

[7] For a first explorative empirical analysis of the workings of Hungarian EGTCs, see Eckardt/Gritsch (2016) and Svensson/Ocskay (2016).

of EGTCs, two centers can be identified, one in Western and Southern Europe and one in Eastern Europe. 3 EU Member States are preferred as countries where an EGTC has its registered office. In Hungary 16 EGTCs have their seat, in France 11, while 8 have their seat in Spain (Pucher/Hauder 2016, Annex 2), with the members of these EGTCs being located in the cross-border regions. This might be a first indicator that both geographic, cultural and political proximity plays a role in adopting EGTCs.

All in all, the EGTC offers an innovative legal form for territorial cooperation in the EU for cross-border, interregional or transnational cooperation among public entities. It follows the strategy of the EU to strengthen the regional level. Empowering the regions by facilitating cooperation among them may also lead to intensified systems competition. In the following section we therefore analyze the potential interrelationship between the legal innovation EGTC and the four types of systems competition outlined in section 2.4.

### 3.3 Systems Competition and the EGTC

The EGTC gives territorial cooperation a more formalized organization. This also implies stricter reporting obligations. Since the organizational standards for the EGTC also comprise supervisory bodies the quality of information provided by EGTCs may also improve in line with the effectiveness of the supervisors. The stronger flow of (better) information from EGTCs to their stakeholders, or vice versa the lower searching costs, may intensify *Yardstick competition* both horizontally and vertically.

The workability of horizontal Yardstick competition will benefit directly from more and better information. But incentives within vertical Yardstick competition have also clearly been strengthened by this top-down legal innovation. The mandatory registration of EGTCs on the European level as well as the ongoing (albeit 'soft') monitoring of EGTCs by the European Commission and the Committee of the Regions contribute to the flow of information and thus to a workable vertical systems competition. This effect is especially important as it has been observed that vertical Yardstick competition is often unsatisfactory without appropriate provisions (Oates 1999, 1133).

To intensify the vertical axis is obviously in line with the EU's strategy to strengthen the regional level. From a Public Choice perspective one may argue that the existence of sub-national legal personalities like the EGTCs could help the EU to even bypass the member states in following its regional strategies. But we focus on these potential power shifts within the

multilevel governance structure only insofar as they lead to changes in the competitive process and its outcome. In this respect, what counts are the political learning processes on the regional level Yardstick competition may induce (Eckardt/Kerber 2007; Okruch 2010).

In addition, the EGTC may also influence *regulatory competition* in its usual (indirect) form, even more – in some instances it may even lead to a direct regulatory rivalry.

The common *indirect* effect of regulatory competition may occur, if and when an EGTC helps regional actors to introduce additional or innovative common goods. Incumbent suppliers may face losses in customers and turnover. As a consequence, they may start to either adapt the EGTC's range and quality of products and services or to lobby for restrictions of the EGTC's range of activities. Hence it is not evident whether systems competition is strengthened or weakened in the long run, even if the initial activity of an EGTC is pro-competitive. Since EGTCs, too, have the choice between an exposure to competition or rent-seeking, they could even initially resort to lobbying activities. As a consequence the effect on systems competition is unclear right from the start. So far, however, most EGTCs do not follow special purposes, but are rather established to apply for and carry out EU funding or for networking objectives. As a consequence, their impact on regulatory competition should be rather negligible for the moment.

From the viewpoint of legal innovation, *direct* regulatory competition is an especially interesting case. Whereas usually actors in systems competition cannot change the 'rules of the game' directly, some members of an EGTC might have a (limited) legislative competence. Actors that could have this kind of double role are self-governing bodies like universities or (at least in some jurisdictions) chambers of commerce, which may also be members of an EGTC. Such EGTCs may not only take part in systems competition, but are themselves able to modify the very rules of competition on the 'constitutional' level. In this way, the EGTC as a legal form creates additional actors which might change the institutions that influence competition, thus leading to additional legal innovations. The first academic EGTC may therefore be an especially interesting example for further research: *Eucor – The European Campus* is an EGTC of universities in the French-German-Swiss border region.[8]

[8] See http://www.eucor-uni.org/en/eucor-european-campus (last access 19/12/2017).

As has been shown above, *locational competition* works through the attraction of mobile factors, like individuals, capital, and companies. EGTCs may intensify locational competition and contribute to efficiency. This may also lead to stronger political competition and a more intense monitoring of (different levels of) government. Finally, in locational competition EGTCs may contribute to the innovativeness of regions in terms of political innovations.

The EGTC as a stable legal form for territorial cooperation helps to organize collective action among regions. It allows for a legal regional integration and by this the internalization of regional externalities. In this respect, EGCTs may increase efficiency in the supply of common goods, help to reach a critical mass for their production and consequently might improve the competitiveness of regions. Higher competitiveness does not only concern private capital but also public funds, so that EGTCs (exactly in line with the EU's initial design) may have an advantage in the rivalry for European or national funds. Altogether, the EGTC may lead to a more intense locational competition.

Given that the formal organization of EGTCs result in more and better information (cf. supra), this would also mean better opportunities for monitoring the regional governments and authorities that are members in an EGTC. In relation to its national governments, EGTCs potentially support the regions in a gradual emancipation (especially relative to the EU), although the national governments still have a certain control as they monitor the scope of activities of EGTCs. As to the supra-national level, the stronger competition for EU-funds may also limit discretion and could thus contribute to competitive checks and balances for the EU. However, the total effect of EGTCs on the monitoring of different levels of government is not easy to assess without detailed analysis.

The allocation of mobile resources in locational competition does not only affect economic efficiency and political accountability. It is also of crucial importance in regard to the innovation and knowledge aspects, i.e. the dynamic effects of competition. Since "(w)e might expect too little experimentation and policy innovation in a highly decentralized public sector" (Oates 1999, 1133), facilitating cooperation of public actors is especially important. Giving territorial cooperation a reliable legal structure also results in the kind of stable environment that is supportive for (political) entrepreneurs (Loasby 2000; Perkmann 2007).

The European legal form of EGTC is an important innovation in vertical systems competition regarding *Free choice of law*. It is unique in the sense that it enables public authorities of various Member States to team up and produce joint services, without requiring a prior international agreement to be signed and ratified by national parliaments. But since the operation of a cross-border joint-venture, though formalized as an EGTC, is not only dependent on its legal form, the ultimate test of the EGTC (as an innovative legal form) is still an open question. The future diffusion of the EGTC will also depend on the further evolution of other parts of the Law. Unsolved legal puzzles for the efficient working of an EGTC comprise details of labor law or of the social insurance of an EGTC's staff. However, these challenges for the legal innovation at hand could be solved by further legal innovations in the future.

**4. Summary and Outlook**

Territorial cooperation among regions in Europe is expected to have several beneficial effects, right up to the aspiration of cross-border cooperation to be "...a kind of Europe closer to the citizens, a bottom-up approach to Europe" (Pasi 2007, 73). This bottom-up approach may bring about legal innovations in itself, but may also need top-down legal innovations in order to be (more) effective – and thus (further) fueling interregional and interjurisdictional competition. In this sense territorial cooperation is indeed an interesting incubator for legal innovations.

This paper makes several contributions both to our understanding of legal innovations and of the EGTC. Based on a concise application of the main insights from innovation economics, political sciences and Law and Economics, we extend the framework for exploring legal evolution in a systematic way. We not only offer a more precise characterization of what constitutes a legal innovation, but also outline the processes of how legal innovations are generated and disseminated. The notion of (Supra-)National Systems of Innovations, which we applied, describes the central mechanisms of legal change that is, statutory legal innovations, which constitute a top-down process, as well as judicial legal-innovations, which result from a bottom-up process. It allows to more accurately capture the systematic nature of legal evolution.

In addition, we identify systems competition as one of the main drivers of legal evolution. We discuss how it impacts legal innovation and change, depending on the particular characteristics of one of the following four types: Yardstick competition, regulatory competition, locational competition or Free Choice of Law.

We apply these findings to the EGTC, which is a rather novel supra-national legal form. It is generated by the EU actors, thus in a top-down statutory process of legal innovation. Since this is a rather new legal form, the database is still too small to perform quantitative tests. However, in a rather explorative way we show that both internal determinants and regional diffusion models are supportive in explaining the adoption of the EGTC.

Finally, we explore the EGTC within systems competition. By applying the four notions of systems competition, we find that the EGTC as a legal innovation may improve both yardstick and locational competition. So far however, there is no clear evidence that it also impacts regulatory competition in its narrow sense or competition among different legal arrangements.

The future evolution set in motion by the experiences made with the EGTC as a legal form with its current characteristics might lead to further legal innovations, eventually generating an even more inclusive EGTC. Systems competition plays an important role as a laboratory for which properties of the EGTC work well under which circumstances. It is a testing ground giving rise to modifications of this legal innovation to better use its potential for cross-border cooperation.

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