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**Shifting Narratives in European Economic Integration:
Trade in Services, Pluralism and Trust¹**

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Shifting narratives in European economic integration: trade in services, pluralism and trust

Ioannis Lianos and Damien Gerard

I. Introduction

At almost 25 years of distance, Cappelletti, Secombe and Weiler, on the one hand, and Delmas-Marty, on the other hand, have associated the European integration process with the “enigma of the ‘one and the many’ that has haunted human civilisation throughout history”,² that is “the dilemma of reaching an equilibrium between, on the one hand, a respect for the autonomy of the individual unit, freedom of choice, pluralism and diversity of action, and, on the other hand, the societal need for cooperation, integration, harmony and, at times, unity”.³ In 1986, Cappelletti et al. attempted to solve that dilemma, and thus the one of European integration, by resorting to the concept of federalism as embodying a “societal philosophy and organizational principle which require a particular balancing of individual and communal interest - a balance between particular and general, peripheral and central, and between autonomy and heteronomy”⁴. In 2009, Delmas-Marty did so by resorting to the formula of “multiple interactions – judicial and normative, spontaneous and imposed, direct and indirect, to link together legal ensembles – national and international”,⁵ as a way “toward harmony”.⁶

At the core of this tentative essay – a feeler, indeed – lays an attempt to uncover a relative shift in the narrative underlying the matrix of European integration – from one of unity and federalism to one of pluralism, harmony and multiple interactions, to

² M. Delmas-Marty, *Ordering Pluralism – A Conceptual Framework for Understanding the Transnational Legal World*, (Hart Publ.:Oxford/Portland, 2009), p. 2.

³ M. Cappelletti, M. Seccombe and J.H.H. Weiler, ‘Integration Through Law: Europe and the American Federal Experience A General Introduction’, in: M. Cappelletti, M. Seccombe and J. H. H. Weiler (eds.), *Integration Through Law*, vol. 1 (Methods, Tools and Institutions), book 1 (A Political, Legal and Economic Overview), (Walter de Gruyter:Berlin/New York, 1986), p. 4.

⁴ *Ibid*, p. 15.

⁵ M. Delmas-Marty, *Ordering Pluralism*, above, p. 14.

⁶ *Ibid*, p.16.

trace and report on manifestations of that shift in the core praxis of the EU system – market integration, and to suggest an alternative conceptualization of its hidden ethos by means of the notions of mutual trust and distrust.⁷ The area of services forms the empirical background illustrating that three-fold proposition for it has presented in recent years an important source of tensions between market integration, regulatory diversity and social values, e.g., in the framework of the adoption of the Services Directive or of prominent cases decided by the Court of Justice. Those instances have further highlighted the historical complexity in promoting cross-border trade in a sector that is by essence “uncommoditized”, relies on inter-personal relations, involves local (and vocal) stakeholders and whose regulation reflects policy options anchored in deep identity loaded social choices, while also accounting by far for the largest share of domestic and regional wealth.⁸ In turn, those constraints have triggered a broad variety of policy interventions, including of a sectoral nature, and form a particularly fertile ground for exploring complex market integration strategies and, generally, for observing a possible evolution in the management of regulatory diversity at EU level. This is the objective of Section I below, which reviews successively legislative instruments and the case law of the Court of Justice in the area of services and beyond.

⁷ Cappelletti et al. relied on federalism as a method rather than in reference to an ideal or optimal state, in a way similar to Delmas-Marty when she emphasizes harmony as generation and multiple interactions as ongoing processes. Moreover, they rejected unity as an absolute value but presented it as only one dimension of federalism as a method and as one of the poles in the balancing process inherent to that method. Likewise, they viewed the failure of Europe to develop into a federal super-state as a virtue and stressed the need to promote the emergence of transnational forms of law and government. Yet, beyond the epistemological weight of the ‘F-word’, they still viewed federalism as a frame, integration as the strength of the frame, the Union as the central authority and the US federal state as a comparative point of reference. Thus, if the approaches of Cappelletti et al. and Delmas-Marty may seem to converge from a methodological point of view, their starting point is different: the former explored ways to reach beyond the static model of the state and the international/national dichotomy, while the latter takes the pluralism of legal orders as a given and as the premise of an attempt to harness ‘*the Great Legal Complexity of the world*’ Likewise, the former relied on federalism to capture the tension between autonomy and heterogeneity, while the latter views autonomy as the source of heterogeneity. Hence, the origins of their respective approach differ, so does their respective way to address the dilemma between the one and the many and, in turn, the narrative underlying their vision of the matrix of the EU system.

⁸ In effect, the internal market in services has continuously been lagging behind in the EU economic integration process, with the result of only 20% of services supplied in the EU having a cross-border dimension, whereas the sector accounts for 70% of EU GDP, 68% of employment, 96% of new jobs creation and constitutes the most important source of foreign direct investment (see: European Commission, *The Internal Market – Ten Years Without Frontiers*, pp. 6 and 22; M. Monti, ‘A New Strategy for the Single Market at the Service of Europe’s Economy and Society’ Report to the President of the European Commission, 9 May 2010, p. 53; Communication from the European Commission of 20 November 2007, A Single Market for the twenty-first Century, Brussels, COM(2007) 724 final, p. 8).

Eventually, then, the revelation of such an evolution will allow for the reformulation of the inner ethos of the European market integration process, moving away from the narrow imagery of the removal of national barriers to trade or regulatory sameness and toward a multi-dimensional paradigm based on the notion of “system trust”. As a paradigm, it does not espouse a deterministic model, but embodies a stochastic process capable of evolving over time in function of the random political shocks that might alter the preferences and values of the actors and thus the probable systemic outcomes. In turn, that envisaged reformulation is a testament to and reveals a shift in the equilibrium between the one and the many in the EU system. Those preliminary propositions are developed in Section II below, which is followed by concluding remarks.

II. The affirmation of pluralistic concerns in EU internal market law

The EU market integration programme, both in its negative or positive dimensions, has long been viewed as a process of re-regulation entailing the replacement of national economic regulations with EU rules,⁹ in pursuance of a functional logic of unity whereby the unity of the market and the unity of law was to contribute to an overarching goal of political unity for Europe.¹⁰ Thus, upon completion of the Customs Union in 1968, the Commission stated that the latter was to be followed by the achievement of an economic union, which required “replac[ing] the old national policies with Community policies”, notably through the “harmonization or unification in the commercial, fiscal, social, transport, and other fields, as provided for in the Treaties”.¹¹

In a context of economic crisis and political stagnation, the 1970’s gave rise to the unfolding of a process of negative integration led by the Court of Justice. At the end of the transition period, the Court endowed successively the Treaty provisions guaranteeing the free movement of goods, persons and services, with direct effect,¹² thereby triggering a flurry of requests for preliminary rulings on the interpretation of those provisions. The most emblematical judgments of that period remain *Dassonville* and *Cassis de Dijon*, in relation to the free movement of goods, which established the sequence of analysis applied by the Court ever since, across all four freedoms: (i) a far-reaching definition of the notion of obstacle to trade, combined with (ii) the possibility to justify the said obstacle by means of mandatory (or imperative) requirements in the general interest applied in a proportionate manner, i.e., appropriate, necessary and reflecting the (lack of) equivalence of the regulatory

⁹ See, eg., A. R. Young, ‘The Single Market – Deregulation, Reregulation and Integration’ in: H. Wallace et al. (eds.), *Policy-Making in the European Union* 6th ed., (Oxford Univ. Press, 2010), p. 107 et seq.

¹⁰ P. Pescatore, ‘Les objectifs de la Communauté européenne comme principes d’interprétation dans la jurisprudence de la Cour de justice’ in: *Miscellanea W. J. Ganshof van der Meersch*, vol. 2, (Bruylant : Brussels, 1972), p. 351. On the classic notion of the unity of the European market, see, eg., Case 14/68, *Walt Wilhelm*, para. 5.

¹¹ Declaration by the Commission on the occasion of the achievement of the customs union on 1 July 1968 [1968] OJ 7/5.

¹² With respect to the free movement of services, see Case 33-74, *van Binsbergen* [1974] ECR p.1299.

framework in place in the country of origin.¹³ Maduro has highlighted the institutional choice inherent to that sequence, “namely that it leaves the ECJ to define the balance between free movement and regulatory aims and therefore to define the appropriate regulatory policy”.¹⁴ In effect, the Court complemented the market-building approach advocated by the Commission with the view to break the path-dependence of actors from national systems and to promote the emergence of a new European majoritarian view reflecting “Community-designed values and concepts”.¹⁵ Even though it also triggered legislative action, negative integration has therefore been viewed as a centralized mechanism of allocation of regulatory competence sheltered from the control of the EU political process.

With the endorsement by the European Council of the Commission White Paper - “Completing the Internal Market” and the introduction by the Single European Act of qualified majority voting for the adoption of approximation measures,¹⁶ the positive integration process was revitalized in the mid-1980 with a view to completing “a fully unified internal market by 1992”.¹⁷ To achieve that objective, mutual recognition and equivalence was to be favoured over the approximation of Member States’ laws and regulations.¹⁸ Yet, the Commission relied largely on the approximation provisions of the amended Treaty to achieve its ambitions. The vast majority of measures adopted in the framework of the single market legislative programme took the form of directives.¹⁹ In a decade, hundreds of them were adopted in a great variety of

¹³ Case 8/74, *Procureur du Roi v Benoît and Gustave Dassonville* [1974] ECR 837, para. 5 and Case 120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)* [1979] ECR 649, paras. 8-11 and 14-15.

¹⁴ M. P. Maduro, *We, the Court: the European Court of Justice and the European economic constitution: a critical reading of article 30 of the EC Treaty* (Hart Publ.: Oxford, 1998), p. 59. On p. 62, the author illustrates his view as follows: ‘After *Cassis de Dijon*, a stream of cases led the ECJ to adopt a policy of giving preference to labelling over mandatory requirements regarding the designation, composition or other characteristics of imported products, which led to a redefinition of many national regulatory policies on the characteristics and designation of goods’

¹⁵ *Ibid.*, p. 72. This is clearly apparent from *Cassis de Dijon*, where the Court, by deciding that the German rule over minimum alcohol content failed the necessity test, replaced it with its own, namely that the minimum alcohol content of beverages ought to be left to the arbitration of supply and demand, *i.e.*, to the market.

¹⁶ See, respectively: (i) Conclusions of the Milan European Council of June 28-29, 1985, Bull. of the Eur. Com., 1985, p. 6/13; and (ii) Single European Act [1987] OJ L169/1.

¹⁷ Communication of the Commission, ‘Completing the Internal Market’, June 14, 1985 (COM(85) 310 final), p.4

¹⁸ *Ibid.*, p. 6.

¹⁹ A. R. Young, ‘The Single Market – Deregulation, Reregulation and Integration’, above, p. 119.

fields,²⁰ either based on product-specific performance requirements combined with fully harmonised provisions involving, e.g., testing methods to guarantee consumer safety (pharmaceuticals, chemicals, automobiles, etc.), or covering large families of products and/or hazards and specifying minimum requirements to be met before being placed on the market, i.e., “new approach directives”.²¹ Beyond its achievements in economic terms,²² the internal market programme transformed radically the way many businesses are conducted in Europe and the success of the venture in “breaking through the old structures inherited from the past”,²³ did not come without traumatic consequences. Indeed, the enterprise was hardly politically neutral or value free: it inevitably involved choices between conflicting values that affected profoundly business cultures and consumer preferences across the EU.²⁴ In turn, the magnitude of those choices led to deep and lasting criticisms of the centralized process whereby they were achieved.

In essence, the criticisms directed at the market integration process, both in its negative or positive dimensions, are rooted in a hiatus between the nature of the means and the magnitude of the ends pursued. Maduro, again, associates four shortcomings with the centralized model of integration, as follows: (i) lack of consideration for national diversity, including cultural and regulatory traditions; (ii) risk of reduction in legislative innovation and experimentation; (iii) risk of evasion in the absence of a developed sense of community or complex enforcement system; and (iv) questionable assumptions as to the EU’s ability to bring added value to the process of economic regulation in terms of efficiency and democracy.²⁵ Those shortcomings have become encapsulated over time in one heavy-weighted and

²⁰ The total body of Internal Market Directives amounted to 1291 in 1995 and increased to 1475 by 2002 (European Commission, *The Internal Market – Ten Years Without Frontiers*, 2002, p. 10, available at: http://ec.europa.eu/internal_market/10years/docs/workingdoc/workingdoc_en.pdf last visited July 15, 2010).

²¹ *Ibid*, p. 20.

²² For a review of the benefits associated with the Single Market, see European Commission, *The Internal Market – Ten Years Without Frontiers*, 2002 and European Commission Staff Working Document, *The single market: review of achievements*, SEC(2007) 1521.

²³ Declaration by the Commission on the occasion of the achievement of the customs union on 1st July 1968 *OJ*[1968] 7/5.

²⁴ A. R. Young, ‘The Single Market – Deregulation, Reregulation and Integration’, above, p.112 and M. P. Maduro, *We the Court*, above, p. 147: ‘many obstacles to trade come from different assessments of what is the right policy, in terms of choice between regulation and free trade or the types of appropriate regulation’.

²⁵ M. P. Maduro, *We the Court*, above, p. 114.

multi-faceted notion: that of (lack of) legitimacy of the Union as a regulatory and political body, under its two “input” and “output” aspects.²⁶

Ironically, by aiming to achieve one of the main objectives set forth in the Treaty of Rome, the internal market programme also sowed the seeds of a profound transformation in policy-making at EU level. Indeed, the acknowledgment of the shortcomings pointed to hereinabove triggered a progressive evolution in the design of EU policies towards new modes of governance reflecting a willingness to improve the inclusiveness of decision-making and the effectiveness of policy outcomes, as clearly apparent, e.g., from the White Paper on European Governance.²⁷ The hypothesis underlying the present section associates that evolution, combined with increased diversity in EU membership and the quantitative and qualitative enlargement of the scope of EU competences,²⁸ with a move from unity to pluralism as the prevalent representation of the relation between the EU and the Member States, which is at the core of the Union’s “register of self-understanding”.²⁹ In other words, it endeavours to link the turn to governance with the emergence of a new narrative underlying the EU integration process – one of pluralism – from which insights can be derived to inform the design of its rules, the performance of its functions, the understanding of its ends and eventually the definition of its nature. In support of that view, it further postulates that the logic of pluralism has even permeated the internal market case law of the Court of Justice, in spite of the latter’s long-standing stance as the ultimate guardian of the unity of the market and that of the law.

²⁶ See, eg., K. Lenaerts and D. Gerard, ‘The Structure of the Union according to the Constitution for Europe: the emperor is getting dressed’, *ELRev.*, 29 (2004) pp. 321-322: (i) input legitimacy relates to the direct legitimisation of political power through the democratic participation of the citizens or their elected representatives in transparent decision-making and constitution-making procedures; and (ii) output legitimacy relates to the extent to which citizens see their preferences mirrored in the outcomes of political processes and therefore accept and support the political order as ‘valid’

²⁷ European Commission, European Governance – a White Paper, COM(2001) 428 final (available at: http://ec.europa.eu/governance/white_paper/index_en.htm (last checked February 5, 2010)).

²⁸ On the link between quantitative and qualitative increases in diversity and policy adaptations, see, eg., E. Philippart and M. Sie Dhian Ho, ‘From Uniformity to Flexibility. The Management of Diversity and its Impact on the EU System of Governance’, in: G. de Burca and J. Scott (eds.), *Constitutional Change in the EU: from Uniformity to Flexibility?* (Hart Publ., Oxford, 2000), p. 300.

²⁹ N. Walker, ‘Legal Theory and the European Union: A 25th Anniversary Essay’, *OJLS*, vol. 25 issue 4 (2005), 581-601, p. 600.

This is not the place for long developments on the notion of legal pluralism.³⁰ Yet, before turning to the examination of manifestations thereof at EU level, some clarifications are required. Even though it took a different turn immediately after,³¹ the very early case law of the Court of Justice enshrines the basic premise of a pluralistic account of the EU system, namely the recognition that “the municipal law of any Member State [...] and Community law constitute two separate and distinct legal orders”.³² In effect, pluralism implies the coexistence of autonomous and valid sources of law, i.e., of different legal orders, within one and the same social field, that is a territory or a population.³³ Pluralism therefore challenges the monopoly of the state as the unique and ultimate source of authority and enables the emergence of a transnational form of law resting on a disconnection between the concepts of state and constitution. In turn, the peace of such coexistence is guaranteed by cooperative mechanisms preventing conflicts between incompatible rules.³⁴ At EU level, by establishing “institutions endowed with sovereign rights”³⁵, Member States not only created a binding system of shared powers and responsibilities backed by “a complete system of legal remedies”,³⁶ but also provided for a system of express and implied cooperation rules including, at primary level, the preliminary ruling procedure and the principles of precedence and direct effect and,³⁷ at secondary level, countless instruments determining the law applicable to a great variety of legal situations and organizing the meso-level of governance where the EU and the Member States interact through their respective institutional structure in the implementation of common policies.

Yet the EU transnational system is not one of “pure” pluralism because it is fundamentally incomplete and emanates from the common volition of a diversity of nation states, each embodying a specific political compact reflecting particular social

³⁰ For a recent thorough discussion, see, eg. ‘Le Pluralisme’ in *Archives de Philosophie du droit*, vol. 49, (2005), p. 499.

³¹ Notably by promoting the idea of the integration of EU law into the laws of each Member State (see, eg., Case 6/64, *Costa v E.N.E.L.*, pp. 593, 594 and 596).

³² See the first preliminary ruling issued by the Court of Justice in Case 13/61, *van Rijn*, section A.

³³ See, eg., R. Michaels, ‘Global Legal Pluralism’, *Duke Public Law & Legal Theory Research Paper Series*, n°259, (July 2009,) 3.

³⁴ See, generally, M. Delmas-Marty, *Ordering Pluralism*, above.

³⁵ Case 26/62, *van Gend & Loos*, above, p. 12.

³⁶ Case 294/83, *Parti écologiste ‘Les Verts’ v European Parliament*, [1986] ECR p. 1339.

³⁷ For a recent discussion of precedence as a conflict rule, see H. G. Hofmann, ‘Conflicts and Integration: Revisiting *Costa v ENEL* and *Simmenthal II*’, in: M. P. Maduro and L. Azoulai, *The Past and Future of EU Law* (Hart Pub. Oxford, 2010), pp. 62-66.

choices and cultural traditions. Consequently, the hybrid nature of the EU system carries particular constraints in terms of legitimation, which mandate the EU to live with, tolerate and indeed embed and experiment that diversity into its actual praxis. As explained hereinafter, the Union has precisely endeavoured in recent years to live by and deliver on that ontological requirement in the exercise of its competences, including of its historical commitment to market integration.³⁸ Before moving on, though, it is worth emphasizing anew the density of the cooperative interactions between the EU and national levels of government so that pluralism in the EU system is hardly one of closeness and separation. Moreover, it rests on a far-reaching institutional structure and elaborated constitutional principles, which condition and ensure the consistency of and compliance with its outcome.³⁹

A. Affirmation of Pluralistic Concerns in EU Internal Market Policies

A more “holistic approach” integrating the pluralistic interests/preferences of the European polity is emerging in the recent European Commission’s review of its positive integration programme⁴⁰. In its Communication on the Citizen’s Agenda, the

³⁸ Already in the early 1990’s, in introducing his essay on *New Directions in European Community Law*, Snyder contended that under a supranational umbrella, the Union ‘increasingly recognises the validity of diverse national policies’ so that, in effect, ‘[C]ommon market law, in a fragmented Europe, is thus mainly a co-ordinating device’ (F. Snyder, *New Directions in European Community Law*, (Weidenfeld and Nicolson, London, 1990), p.18. Likewise, Mattera has presented on various occasions in the past the principle of mutual recognition as a means allowing for the accommodation of national diversities (see, eg., A. Mattera, ‘L’article 30 du traité CEE, la jurisprudence ‘Cassis de Dijon’ et le principe de la reconnaissance mutuelle – Instruments au service d’une Communauté plus respectueuses des diversités nationales’, *RMUE*, issue 4 (1992), 13 ; A. Mattera, ‘L’Union européenne assure le respect des identités nationales, régionales et locales en particulier par l’application et la mise en œuvre du principe de reconnaissance mutuelle’, *Rev. Drt. U.E.*, issue 2 (2002), 217-239. Of course Snyder was right to point to early instances of instruments relying heavily on the coordination of national rules (for a glaring example, see also Regulation 1408/71 on the application of social security schemes to employed persons and their families moving within the Community [1971] OJ L 149/2); yet the elaboration of those instruments remained centralized and coordination was arguably the result of regulatory constraints rather than the outcome of a conscious political choice. Likewise, mutual recognition, even though it carried the potential of giving transnational relevance to domestic requirements, was for a long time commanded centrally and poorly organized, with a consequent lack of certainty and effectiveness.

³⁹ To use the terminology of Delmas-Marty, cooperative interactions in the EU system are ‘verticalized’ (see *Ordering Pluralism*, above. p.17).

⁴⁰ On the ‘holistic approach’, see I. Lianos, ‘Shifting Narratives in the European Internal Market: Efficient Restrictions of Trade and the Nature of “Economic” Integration’, *EBLR*, 21(5) (2010), 705-760. On the importance of ensuring citizens’ support for the project of the Internal Market and the need to reconcile the single market and the social and citizens’ dimension in the context of the Treaty logic of ‘highly competitive social market economy’ see M. Monti, *A New Strategy for the Single Market – At the service of Europe’s Economy and Society* (9 May 2010), Chapter 3.

Commission noted the importance of economic integration “in making the EU stronger globally” but also emphasized the importance of the value of solidarity in achieving the objectives of the Union⁴¹. In accordance with the objectives set by the Constitutive Treaties⁴², the Union should aim to promote a higher quality of life, social cohesion, environmental protection, by ensuring “citizen’s existing rights of access to employment, education, social services, health care and other forms of social protection across Europe”⁴³. In order to achieve these aims, the Commission acknowledges the importance of working in partnership with national governments.

There are various manifestations of this shift of narrative on the objectives of economic integration in Europe. As it is explained in the Commission’s Communication on a “single market for 21st century Europe”, the Internal Market must be “more responsive to the expectations and concerns of citizens”⁴⁴. It follows that the Single Market policy goes “hand in hand with social and environment policies to contribute to sustainable development goals” and needs to “encompass a strong social and environmental dimension”⁴⁵. The Commission’s Staff Working Document accompanying the Communication, also notes that the Single Market brought benefits to citizens “in the form of more choice, higher quality and lower prices” but “times have changed and Single Market policy should change accordingly, to ensure that it responds to the needs of today’s citizens”⁴⁶. Finally, in its recent Communication “Towards a Single Market Act”, the Commission seems to have taken stock of the integration of the concept of “social market economy” in the Treaty of Lisbon and proposed to conduct an “in-depth analysis of the social impact of all proposed legislation concerning the single market”⁴⁷.

The implications of this rhetorical shift are important. First, as the Commission acknowledges,

⁴¹ Communication from the Commission to the European Council – A Citizen’s Agenda, COM(2006) 211 final.

⁴² Article 3(3) TEU (after Lisbon), former Article 2 TEU.

⁴³ Communication from the Commission to the European Council – A Citizen’s Agenda., at 5.

⁴⁴ Communication for the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, A Single Market for the twenty-first Century, COM(2007) 724 final, at 3 (hereinafter Single Market for the twenty-first Century Communication).

⁴⁵ *Ibid.*, pp. 3-4.

⁴⁶ Commission Staff Working Document, Instruments for a modernized single market policy (MSMP), SEC(2007) 1518, at 5.

⁴⁷ According to the most recent Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions, Towards a Single Market Act, COM(2010) 608 final, at 23.

“(m)arket opening and economic integration have social and environmental impacts, which must be factored in - both in Europe and abroad. This requires a better assessment of the impact of decisions and a better collective capacity to anticipate, foster and manage changes implied by greater opening and technological developments. This also implies getting market prices to reflect their real costs on society and the environment, as well as making citizens more aware of the social and environmental impacts of their consumer choices”⁴⁸.

It is further recognized that “the ultimate objective of all economic activity is to provide the goods and services that citizens require in the most efficient manner”⁴⁹. The conception of “citizens as consumers” becomes “clearly central to the Single Market”, which should take “more seriously” into account the distributional impact of the Internal Market policies, its social effects and the consumer/citizen side⁵⁰. The new approach to positive market integration will be more evidence-based and “impact-driven”, relying on a number of tools, also employed in competition policy, such as sector inquiries, or specific to the Single Market policy, such as the “consumer markets scoreboard” in order to provide information on how markets perform “in terms of economic and social outcomes for consumers, and where intervention may be needed”⁵¹. The Commission will use an “optimal mix of instruments”, that would combine more flexible approaches to legislation (e.g. Lamfalussy process) and non-binding tools (e.g. codes of conduct), as well as competition law and policy tools (e.g. competition advocacy) in a “synergetic manner” to achieve greater welfare gains for the European citizens/consumers⁵².

Second, there is a move from a “more legalistic approach to a more economic approach” that focuses on both static (consumer choice, lower prices, better environmental standards) and dynamic (innovation) efficiency⁵³. As the Commission explained in the Staff Working Document accompanying the Communication,

⁴⁸ Single Market for the twenty-first Century Communication, p. 10.

⁴⁹ Commission Staff Working Document, p. 17.

⁵⁰ Ibid, p. 17.

⁵¹ Ibid, p. 18.

⁵² Ibid, p. 8-15.

⁵³ See F. Ilzkovitz, A. Dierx, V. Kovacs and N. Sousa, European Commission DG Economic and Financial Affairs, *European Economy, Steps towards a Deeper Economic Integration: the Internal Market in the twenty-first century A Contribution to the Single Market Review*, No 271, (January 2007,) pp. 17-18.

“(i)n the past, Single Market policy was mainly about ‘integration through law’. The aim was to remove legal barriers to cross-border trade. This was achieved through ‘negative’ integration measures and ‘positive integration measures’ [...] In today’s context, legal integration can no longer be the Single Market’s sole or primary ambition”⁵⁴.

The emphasis put on regulatory differences as a sign of success of the completion of the Single market is no longer the leitmotiv of the internal market project. For the Commission, “policies need to be rethought so as to ensure that markets are not only integrated but can function well – thereby improving consumer welfare and raising productivity”⁵⁵. The different social, economic and political context of various Member States may require different institutional choices for satisfying consumer welfare, for example, if this is the goal to achieve.

Third, the Commission recognizes the importance of developing an “inclusive” perspective that will consider the interaction of the Internal Market project with other EU “and national policies, among others to address adjustment costs”⁵⁶. The interaction with other policies does not go one way only. Inge Govaere observes that “social, environmental, and public health policy instruments are drafted with due regard to the internal market principles of non-discrimination and market access”, so as to avoid “an ex post interference of internal market law”; she cites the Commission’s Communication on “Opportunities, Access and Solidarity: Towards a New Social Vision for 21st Century Europe”, drawing “attention to issues of market access and non-discrimination in the social field”⁵⁷. The Lisbon Treaty has also added a broad horizontal integration provision in Article 9 of the TFEU stating that “(i)n defining and implementing its policies and activities, the Union shall take into account requirements linked to the promotion of a high level of employment, the guarantee of adequate social protection, the fight against social exclusion, and a high level of education, training and protection of human health”⁵⁸. Such broad policy integration provision did not exist in the previous Treaties, albeit in some specific

⁵⁴ Commission Staff Working Document, above, p. 5.

⁵⁵ Ibid, p. 7.

⁵⁶ Ibid, p. 20.

⁵⁷ I. Govaere, ‘The Future Direction of the E.U. Internal Market on Vested Values and Fashionable Modernism’, *Columbia J Eur L*, 16 (2009), 67-80, 77.

⁵⁸ Article 9 TFEU.

areas, such as environmental protection⁵⁹. The inclusion of these provisions should prompt the Commission and arguably the Courts to grant more importance to broader public interest concerns than the facilitation of intra-community trade.

The success of the “holistic approach” requires, however, important institutional changes in particular for the interaction between public authorities at the EU, the national and/or local levels. Enhancing administrative cooperation between the different players is a key priority in the Commission’s New Internal Market strategy. Following a paradigm that has flourished in the enforcement of competition law, national administrations are included in a variety of networks⁶⁰ in the area of goods, services, consumer protection, social policy area, where they exchange information with each other⁶¹. The Services Directive is a good example of this new approach that promotes cooperation, communication and exchange of information, by including an entire section (Chapter VI) on administrative cooperation between Member States, and by providing mechanisms for mutual assistance and joint monitoring⁶².

There is the perception that national action is a complement to EU action. The idea of a “partnership” between Member States and the EU Institutions, of a “joint venture” in which Member States “have a shared stake” is the new rhetoric advanced by the Commission⁶³, in opposition to the prevalent perception that Member States and the Union have antagonistic interests, in particular with regard to the enforcement of the Internal Market rules. This partnership approach “goes beyond the already established cooperation in a number of single market policy areas” and “requires establishing and maintaining closer cooperation within and between the Member States, and with the Commission, in all areas that are relevant for the single market”; It also “implies that Member States assume shared responsibility for and

⁵⁹ Article 6 TEC, now Article 11 TFEU.

⁶⁰ See for an interesting survey, Commission Staff Working Document, Administrative Cooperation in the single market, SEC(2009) 881.

⁶¹ See, for instance, the Internal Market Information System (IMI) which facilitates the cooperation between national administrations in the implementation of the Internal Market legislation in the area of services or the European Public Administration Network (EUPAN) that aims to support the continuous development of national public administrations with the task to conceive and implement the single market. On the practical arrangements for the exchange of information between national authorities in the internal market, see Commission Decision 2009/739/EC setting out the practical arrangements for the exchange of information by electronic means [2009] OJ L 263/32.

⁶² Chapter VI of Directive 2006/123/EC of the European Parliament and of the Council on services in the Internal Market OJ (2006) L 376/76. See our developments *infra*.

⁶³ Commission Staff Working Document, p. 33.

therefore a more proactive role in managing the single market”⁶⁴. The Member States are encouraged to “carry out regular evaluation and assessment of national legislation to ensure full compliance with single market rules and in so doing keep under review any use of exemptions or derogations provided for in existing single market rules”⁶⁵.

The holistic approach also requires the broadening of the stakeholder’s involvement in the management and monitoring of the Internal Market. The creation of European consumer centres, the “points of single contact” introduced by the Services Directive⁶⁶, the creation of consumer complaints networks or Single market centres or the inclusion of users in advisory panels increase considerably the possibilities of participation of consumers in the management of the internal market and the integration of pluralistic concerns in the design of the internal market policies and their objectives.

B. Affirmation of Pluralistic Concerns in the EU Internal Market Case Law

As noted, it is postulated that the affirmation of pluralistic concerns has permeated up to the most sacred sanctuary of the logic of unity and of the one-dimensional imagery of market integration as entailing the removal of national barriers to trade, namely the case law of the Court of Justice. To perceive a possible evolution in the internal market case law, while remaining mindful of the limits inherent to the casuistry, it is useful to go back in history to the early 1970s, following the completion of the transitional period.

Then, in *van Binsbergen*, the Court endowed the equivalent of Article 56 TFEU, which prohibits “restrictions on freedom to provide services within the Union”, with direct effect so that it “may therefore be relied on before national courts, at least in so far as they seek to abolish any discrimination against a person providing a service by reason of his nationality or of the fact that he resides in a Member State other than that in which the service is to be provided”.⁶⁷ At the time, the application of Article 56 TFEU was therefore premised on the existence of a direct discrimination, even

⁶⁴ Commission Recommendation of 29 June 2009 on Measures to Improve the Functioning of the Single Market [2009] OJ L 176/17, recital 5.

⁶⁵ *Ibid.*, para 7.

⁶⁶ Article 6 of Directive 2006/123/EC.

⁶⁷ Case C-33/74, *van Binsbergen* [1974] ECR 1299, para. 27.

though the Court hinted that an obstacle to trade could also derive from requirements “which may prevent or otherwise obstruct the activities of the person providing the service”.⁶⁸ The Court then carved an exemption for those restrictions which “have as their purpose the application of professional rules justified by the general good – in particular rules relating to organization, qualifications, professional ethics, supervision and liability – which are binding upon any person established in the state in which the service is provided”.⁶⁹ In turn, the assessment of such exemption was to be carried out “taking into account the particular nature of the services to be provided”.⁷⁰ Like several of the early services cases, *van Binsbergen* involved a residence requirement, in *casu* for legal representatives other than attorneys, which was held contrary Article 56 TFEU “if the administration of justice can satisfactorily be ensured by measures which are less restrictive, such as the choosing of an address for service”⁷¹.

In the following years, in particular in the post-*Cassis de Dijon* era, i.e., the 1980’s, the Court of Justice endeavoured to clarify the sequencing of its analysis and to broaden the scope of Article 56 TFEU, that is of the range of restrictions capable of falling within its ambit. In a stream of insurance cases, for example, residence and licensing requirements were found to “constitute restrictions on the freedom to provide services inasmuch as they increase the cost of such services in the State in which they are provided”.⁷² Those restrictions may however be justified by “imperative reasons relating to the public interest” if they are “applied to all persons or undertakings operating within the territory of the state in which the service is provided”, i.e., in a non-discriminatory fashion, if they actually protect “the interests which such rules are designed to safeguard”, i.e., appropriate, if “the public interest is not already protected by the rules of the state of establishment”, i.e., equivalence, and if “the same result cannot be obtained by less restrictive rules”, i.e., necessity.⁷³ This presentation may appear somewhat misleading, though, as the sequencing was not as clear by the time, but at least all elements that came to constitute the internal

⁶⁸ *Ibid.*, para. 10.

⁶⁹ *Ibid.*, para 12.

⁷⁰ *Ibid.*

⁷¹ *Ibid.*, para. 16.

⁷² See, *eg.*, Case C-205/84, *Commission v. Germany* [1986] ECR 3755, para 28 and references provided there.

⁷³ *Ibid.*, paras. 27-29.

market test were present. The notion of mutual recognition acquired particular significance in the late 1980's, both at the level of the definition of the restriction and of its possible justification. Thus in *Stichting Gouda*, for example, a restriction was found to arise out of the "application of national rules which affect any person established in the national territory to persons providing services established in the territory of another Member States who already have to satisfy the requirements of that State's legislation", i.e., creating a so-called double burden.⁷⁴ In the same case, the Court came to exclude the possibility of justifying the national rules a quo, regulating advertising on cable television, "if the requirements embodied in that legislation are already satisfied by the rules imposed on those persons in the Member State in which they are established".⁷⁵ The reasoning, which may appear cyclical at first sight, was later clarified in *Säger*.

Indeed, in the early 1990's, *Säger* confirmed the expansion of Article 56 TFEU to non-discriminatory restrictions, thus moving toward a market access standard, and induced thereby a convergence of the test applicable to services with the one applicable to goods at the time. Thus the prohibition of barriers to trade in services was to cover not only direct discrimination "but also the abolition of any restriction, even if it applies without distinction to national providers of services and to those of other Member States, when it is liable to prohibit or otherwise impede the activities of a provider of services established in another Member States where he lawfully provides similar services".⁷⁶ The question from then on would rest with the substance of the term "impede" or "impediment to" the cross-border supply of services. Would the application of any domestic requirement to foreign-based services providers amount to a restriction? Or does it have to display certain plus-factors and, in the affirmative, which ones? An increase in the costs of the supply of services, but then, in what proportion? Eventually, *Säger* also clarified the stages of the proportionality assessment applicable to the justification phase of the internal market test: the domestic requirement(s) must be appropriate (i.e., "objectively necessary") to ensure compliance with an imperative reason relating to the public interest that is not protected by the rules to which the service provider is subject in its Member State of establishment (equivalence), and it must not exceed what is

⁷⁴ Case C-288/89, *Stichting Gouda* [1991] ECR I-4007, para. 12.

⁷⁵ *Ibid*, para. 13.

⁷⁶ Case C-76/90, *Manfred Säger v Dennemeyer & Co. Ltd* [1991] I-4221, para. 12.

necessary to attain those objectives.⁷⁷ Over the same period, the Court of Justice further confirmed that Article 56 TFEU covers restrictions, including of a fiscal nature, affecting not only the suppliers but also the beneficiaries of services if they “operate to deter” those seeking a particular service, such as pension, life invalidity or sickness insurance coverage, “from approaching insurers established in another Member State”.⁷⁸ Again, the actual contours of that deterrence requirement would remain a source of endless questioning from then on.

The convergence between the internal market test applicable to goods and services will last but with one important exception. In 1995, the Court declined indeed to extend to the area of services its *Keck and Mithouard* case law excluding non-discriminatory measures governing selling arrangements from the scope of the free movement of goods.⁷⁹ The relevant case, known as *Alpine Investments*, pertained to the prohibition of cold calling for the purpose of selling investment products; contrary to selling arrangements, the Court found, the prohibition at issue actually did “directly affect access to the market in services in the other Member States [where customers are located] and is thus capable of hindering intra-Community trade in services”.⁸⁰ Indirectly, the Court refused therefore to distinguish between the service and the way it is supplied, while at the same time expressly relying on the notion of “market access” that has come to qualify that of trade impediment. In passing, it also confirmed that restrictions to cross-border trade in services can emanate equally from the State of destination and from the State of origin of the supplier.⁸¹ In the examination of the necessity of the prohibition on cold calling in light of the public interest in protecting investor confidence in the domestic financial markets, the Court upheld the measure and expressly allocated regulatory jurisdiction to the Member State from which the telephone calls were made by judging that it was “best placed to regulate cold calling”.⁸² In doing so, it insisted on the practical constraints relating to the control of calls emanating from another Member State and based its assessment on the effectiveness of such control.

⁷⁷ Ibid, para 15.

⁷⁸ See, eg., Case C-204/90, *Bachmann* [1992] ECR I-249, para. 31 (at stake the deductibility of life insurance contributions).

⁷⁹ Joined Cases C-267 and 268/91, *Keck and Mithouard* [1993] ECR I-6097, para. 16.

⁸⁰ Case C-384/93, *Alpine Investments* [1995] ECR I-1141, paras. 37-38.

⁸¹ Ibid, para. 30.

⁸² Ibid, para. 48.

This historical overview ends in the late 1990's/early 2000's with the *Smits & Peerbooms* case where the Court confirmed that “the special nature of certain services does not remove them from the ambit of the fundamental principle of freedom of movement” so that even social security rules – *in casu* a prior authorization scheme conditioning the benefit of the reimbursement of health treatments incurred abroad – are subject to the discipline of Article 56 TFEU.⁸³ The Court then examined the scheme both from the point of view of the beneficiary and the one of the potential suppliers and while confirming the association between the notions of restriction and deterrence in relation to the former, volunteered a rather ill-defined standard for the determination of the scope of Article 56 as precluding “the application of any national rules which have the effect of making the provision of services between Member States more difficult than the provision of services purely within one Member State”.⁸⁴ In retrospect, the question arises whether such statement does not represent the ultimate negation of regulatory diversity in so far as the cross-border supply of services would seem necessarily “more difficult” and/or to “involve additional costs” from a regulatory point of view, than doing so within a single Member State.

With the above background in mind, the following sections explore the latest case law of the Court of Justice in the area of services, with incursions beyond, with a view to highlighting an evolution in the application of the internal market test revealing an emerging praxis of pluralism. The two main stages of the test are reviewed successively: first the interpretation of the notion of restriction to the freedom to provide services and second the assessment of the proportionality of the restriction(s) at stake in light of the alleged public interest to safeguard.

1. Restriction Criteria

A study of the most recent services case law of the Court of Justice reveals a lasting ambiguity as to the content of the notion of “restriction” to trade. To be sure, those cases involving direct discrimination or poorly concealed protectionist measures are relative straightforward, especially when they are reminiscent of past

⁸³ Case C-157/99, *Smits & Peerbooms* [2001] ECR I-5473, para. 54.

⁸⁴ *Ibid*, para. 61 (and references provided there).

practices such as residence requirements or discriminatory taxation.⁸⁵ Situations where the supply of a particular service is prohibited or entrusted in a single operator are relatively unproblematic.⁸⁶ Cases pertaining to classic issues such as the posting of workers abroad have raised concerns related to the type of practice found to constitute a restriction, such as collective actions, but less as to the reasoning concerning the restrictive effects thereof.⁸⁷ Conversely, the circumstances in which a measure applicable without distinction may be deemed to amount to a restriction – i.e., market access cases – continue to raise questions. Even if indicia of a possible “turn to pluralism” are more apparent in the review of the proportionality of requirements aimed to safeguard public policy interests, two developments are worth mentioning at this stage.

1.1 A margin of diversity?

The recent Italian auto insurance case, which involved the obligation for insurance provider to contract with any vehicle owners domiciled in Italy, offers a good starting point to illustrate the lasting ambiguity in the application of the market access criterion.⁸⁸ The Court starts with a now widespread formula according to which “the term ‘restriction’ within the meaning of Article [56 TFEU] covers all measures which prohibit, impede or render less attractive the freedom of establishment or the freedom to provide services”.⁸⁹ Interestingly, it then underlines that mere regulatory diversity, i.e., “the fact that other Member States apply less strict, or more commercially favourable, rules to providers of similar services established in their

⁸⁵ See, eg.: (i) Case C-546/07, *Commission/Germany* [2010] ECR I-not yet published, involving a residence requirement for those providers willing to conclude a works contract with Polish undertakings in order to provide services in Germany; and (ii) Case C-169/08, *Presidente del Consiglio dei Ministri* [2009] ECR I-not yet published, involving a local tax for stopovers made by aircrafts or boats operated by persons having their tax domicile outside the territory of the region of Sardegna.

⁸⁶ See, eg.: (i) Case C-36/02, *Omega* [2004] ECR I-9609, para. 25, where the operation of a laser game ‘lawfully marketed in the United Kingdom’ was prohibited in Germany; or (ii) the *Gaming cases* such as Case C-42/07, *Liga Portuguesa* [2009] ECR I-7633, para. 52 and Case C-258/08, *Ladbroke/Lotto* [2010] ECR I-not yet published, para. 16.

⁸⁷ See, eg., Case C-341/05, *Laval* [2007] ECR I-11767 and Case C-438/05, *Viking* [2007] ECR I-10779.

⁸⁸ Case C-518/06, *Commission/Italy* [2009] ECR I-3491. See, also, eg., Case C-258/08, *Ladbroke/Lotto* [2010] ECR I-not yet published, para. 15.

⁸⁹ *Ibid.*, para. 62.

territory”, is not constitutive of a restriction⁹⁰. That gesture toward the acceptance of a coexistence of different regulatory standards across the EU implies logically that a “margin of diversity” ought to be left to Member States within which their domestic rules are not likely to be found restrictive of cross-border trade. Thus, only those measures found to “affect access to the market for undertakings from other Member States” would be deemed to hinder intra-Community trade.⁹¹ In turn, the Court of Justice considers that market access is affected in the case a quo because, by “oblige[ing] insurance undertakings which enter the Italian market to accept every potential customer, that obligation to contract is likely to lead, in terms of organisation and investment, to significant additional costs for such undertakings”.⁹² In particular, they “will be required to re-think their business policy and strategy, inter alia, by considerably expanding the range of insurance services offered”.⁹³ The margin of diversity left to Member States appears therefore particularly thin and the notion of restriction to market access to be more a matter of degree – of “scale” of “changes and costs”⁹⁴ - than kind. In turn, that criterion continues to leave the scope of Article 56 TFEU wide open, quite unsettled and, in effect, a matter of case by case appreciation for the Court of Justice, which seeks to retain thereby the potential for allocating regulatory jurisdiction. This is equally apparent from a recent establishment case, for example, in which the Court found that a rule making the opening of new roadside service stations in Italy subject to minimum distances requirements between service stations affected access to the activity of fuel distribution.⁹⁵

The notion of margin of diversity can be found in other recent cases relating, e.g., to demographic limitations on the establishment of pharmacies in Spain.⁹⁶ In that case, the Court of Justice derived such margin from the “power of Member States to organise their social security system” and to “determine the level of protection which they wish to afford to public health and the way in which that level is to be

⁹⁰ Ibid, para. 63. A similar reference can already be found in Case C-384/93, *Alpine Investments* [1995] ECR I-1141, para. 27.

⁹¹ Ibid, para. 64.

⁹² Ibid, para. 68.

⁹³ Ibid, para. 69.

⁹⁴ Ibid, para. 70.

⁹⁵ Case C-384/08, *Attanasio* [2010] ECR I-not yet published, para. 45.

⁹⁶ Joined Cases C-570/07 and C-571/07, *Blanco Pérez and Chao Gomez* [2010] ECR I-not yet published.

achieved”.⁹⁷ Yet, the affirmation of that “measure of discretion” did not seem to affect the actual assessment of the notion of restriction, which involved, it is true, a classic system of prior authorization.⁹⁸ Moreover, in another case involving “the power of the Member States to organise their social security systems”, the Court appeared to deny any margin of diversity by taking the view that Article 56 TFEU “precludes the application of any national rules which have the effect of making the provision of services between Member States more difficult than the provision of services entirely within a single Member State”.⁹⁹ That case related, however, to a difference of treatment in the coverage of patients authorized to receive hospital care in another Member State. The same terminology was used in a case involving a different recovery period for taxes due on assets held inside or outside the territory of The Netherlands, which was deemed to “make it less attractive for [...] taxpayers to transfer assets to another Member States in order to benefit from financial services offered there”.¹⁰⁰ Eventually, the “more difficult” standard was merged with that of market access in a case involving the prohibition of advertising on national television networks for medical and surgical treatments carried out in private health care establishments in Italy.¹⁰¹ Earlier on, in *Rüffert*, the Court held that a mere difference in the minimum rates of pay imposed in the country of supply of services and in that of establishment was such as to impose “an additional economic burden that may prohibit, impede or render less attractive the provision of their services in the host Member State”.¹⁰²

As noted, the Court of Justice appears more inclined overall to give operational significance to the notion of margin of diversity, i.e., tolerance for the coexistence of different regulatory systems across Member States, at the level of the proportionality review.¹⁰³ In contrast, at the prior level of the assessment of the existence of a restriction to trade, references to regulatory diversity, notably in relation to measures

⁹⁷ Ibid, paras. 43-44.

⁹⁸ Ibid, para. 44.

⁹⁹ Case C-211/08, *Commission/Spain* [2010] ECR I-not yet published, para. 55. The reason for such strict stance might lie with the similarities of the case with the earlier *Smits & Peerbooms* case (C-157/99, see above).

¹⁰⁰ Joined Cases C-155/08 and C-157/08, *X and Passenheim-van Schoot* [2009] ECR I-5093, paras. 32 and 39.

¹⁰¹ Case C-500/06, *Corporacion Dermoestetica* [2008] ECR I-5785, para. 33: ‘Those rules are, therefore, liable to make it more difficult for such economic operators to gain access to the Italian market’.

¹⁰² Case C-346/06, *Rüffert* [2008] ECR I-1989, para. 37.

¹⁰³ See, eg., Case C-42/07, *Liga Portuguesa* [2009] ECR I-7633, paras 58 et seq.

applicable indistinctively, seem to have little impact on the interpretation of that concept, which continues to be associated with the loose notion of market access. The indeterminacy of that notion is further illustrated by the *Mobistar* case involving municipal taxes on mobile communications infrastructures (e.g., masts and antennae), which the Court interpreted as falling outside the scope of Article 56 TFEU.¹⁰⁴ Its reasoning started with a classic reminder of the fact that measures indistinctively applicable may still amount to a restriction of cross-border trade if they are “liable to prohibit or further impede the activities of a provider of services established in another Member State”.¹⁰⁵ It then resorted to a strict reading of Article 56 TFEU as precluding “the application of any national rules which have the effect of making the provision of services between Member States more difficult than the provision of services purely within one Member State”.¹⁰⁶ It further added a third premise to its reasoning, namely that “measures, the only effect of which is to create additional costs in respect to the service in question and which affect in the same way the provision of services between Member States and that within one Member State, do not fall within the scope of Article [56 TFEU]”. That last statement appears difficult to reconcile with other cases, where the additional costs incurred by services providers due to domestic requirements in the host Member States were found constitutive of a restriction. Yet, the Court also held in *Mobistar* that there was “nothing in the file to suggestion that the cumulative effect of the local taxes compromises freedom to provide mobile telephony services”, thereby hinting that, conversely, such cumulative effect could form the basis for a restriction. Then, again, the question arises of the magnitude of the cumulative costs necessary to form a restriction – i.e., when does a measure loses its neutrality to become restrictive – and of the dissatisfaction of a solution leaving that assessment in the hands of the Court of Justice, on a case-by-case basis.

At this stage, the above findings suggest the following three considerations. First, the Court of Justice appears unwilling to limit the scope of Article 56 TFEU and of its own power to review the opportunity of national regulations affecting the supply of

¹⁰⁴ Joined Cases C-544/03 and C-545/03, *Mobistar/Commune de Fléron* [2005] ECR I-7723. Note, however, that the Court does not make an express reference to the notion of ‘access’ in that case, even though it clearly involves a measure applicable ‘without distinction to national providers of services and to those of other Member States’ (para. 29).

¹⁰⁵ *Ibid*, para. 29.

¹⁰⁶ *Ibid*, para. 30.

services, in a context of underdevelopment of the internal market in that important field of the economy. Second, the lack of established limitations to the scope of Article 56 TFEU shows the limits, paradoxically, of an internal market test based on the objective of removing national barriers to trade, for it does not reflect the variety of circumstances, demands and contexts presiding over the enactment of domestic regulations. Third, it is often argued that the two parts of the internal market test are intertwined or even interdependent so that an allegedly “light” restriction would be more prone to justification, and vice-versa. Even if it may carry some truth from an empirical perspective, as apparent from some of the cases reviewed hereinafter, this truism remains problematic from a normative point of view and is of little help in identifying the narrative underlying the European economic integration process.

1.2 Taxing diversity?

In tracing signs of a greater tolerance of the Court of Justice for the coexistence of different regulatory standards, a second notable development in the recent internal market case law, with immediate consequences this time, relates to the Court’s refusal to allocate regulatory jurisdiction in double taxation cases. Leaving the area of services to enter that of free movement of capital allows indeed for an interesting illustration of the pluralist hypothesis formulated above.

In essence, the Court was asked in various cases whether Article 63 TFEU prohibited the double taxation of dividends, i.e., the taxation of the same income in the country of origin of the income, by deduction at source, and then in the country of residence of the taxpayer as part of his revenues without providing for the possibility of setting off the former against the latter.¹⁰⁷ Even though the cases involved situations of double fiscal burden, susceptible of affecting investment decisions, the Court refused to find a restriction on the movement of capital between Member States in the absence of “any distinction between dividends from companies established in [e.g., Belgium and dividends from companies established in another

¹⁰⁷ See in particular: Case C-513/04, *Kerckhaert & Morres* [2006] ECR I-10967; Case C-128/08, *Damseaux* [2009] ECR I-6823. See also C-194/06, *Orange European Smallcap Fund* [2008] ECR I-3747.

Member State” as to the tax rate applicable in the taxpayer’s country of residence.¹⁰⁸ Conversely, it considered that the situation resulted from the mere “exercise in parallel by two Member States of their fiscal sovereignty” and that preventing double taxation in those cases would “amount to granting a priority with respect to the taxation of that type of income to the Member State in which the dividends are paid”,¹⁰⁹ which it was not prepared to do.

To justify its reluctance, the Court of Justice emphasized that direct taxation falls within the competence of the Member States, that it is for each Member State to organise its tax system and to define the tax base and the tax rate applicable to the taxation of dividends and,¹¹⁰ in particular, that “no uniform or harmonisation measure designed to eliminate double taxation has yet been adopted at Community law level”,¹¹¹ with the consequence that “Member States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, particularly with a view to eliminating double taxation”.¹¹² In other words, in the absence of “any general criteria [provided for in Community law] for the attribution of areas of competence between the Member States in relation to the elimination of double taxation”, it is “for the Member States to take the measures necessary”.¹¹³

The solution adopted by the Court of Justice in those cases is somewhat surprising in view of its past internal market case law, which included various attempts at palliating for a lack of legislative activity. Likewise, it is common ground that no “nucleus of sovereignty” is beyond the reach of Union law.¹¹⁴ Yet, the reasoning of the Court suffers little ambiguity: in the absence of any measure adopted at EU level with a view to preventing double taxation, generally, Article 63 TFEU does not require giving precedence to one regulatory solution, e.g., taxation at

¹⁰⁸ Case C-513/04, *Kerckhaert & Morres*, above, para. 17. In contrast, the Court held that in earlier cases in which it found a restriction, ‘the laws of the Member States at issue did not treat in the same way dividend income from companies established in the Member State in which the taxpayer concerned was resident and dividend income from companies established in another Member State, thereby denying recipients of the latter dividends the tax benefits granted to others’ (Ibid., para. 16, referring to Case C-35/98 *Verkooijen* [2000] ECR I-4071, Case C-315/02 *Lenz* [2004] ECR I-7063 and Case C-319/02 *Manninen* [2004] ECR I-7477).

¹⁰⁹ See, respectively, Case C-513/04, *Kerckhaert & Morres*, para. 20 and Case C-128/08, *Damseaux*, para. 32.

¹¹⁰ Case C-128/08, *Damseaux*, above., paras. 24 and 25.

¹¹¹ Case C-513/04, *Kerckhaert & Morres*, above., para. 22.

¹¹² Case C-128/08, *Damseaux*, above, para. 30.

¹¹³ Case C-513/04, *Kerckhaert & Morres*, above, paras. 22-23.

¹¹⁴ See, eg., K. Lenaerts, ‘Constitutionalism and the Many Faces of Federalism’, *AJCL*, 38(2) (1990), 205-262, p. 220.

source, over another, e.g., taxation at the place of the taxpayer's residence. Is the Court suddenly stretching – i.e., taxing – the boundaries of regulatory diversity? A comparison with the *Laval* case reveals a possible willingness to defer to the legislature those cases involving policy choices in areas where no consensus at EU level has emerged.¹¹⁵ Thus, in *Laval*,¹¹⁶ the Danish and Swedish Governments submitted that the right to take collective action in the context of negotiations with an employer fell outside the scope of Article 56 TFEU because, pursuant to Article 153(5) TFEU, the “Community has no power to regulate that right”.¹¹⁷ Yet, the Court held that the exercise of the right to collective action was to take place in compliance with EU law and therefore that it could not be excluded from the domain of freedom to provide services.¹¹⁸ In effect, *Laval* involved alleged restrictions to the posting of workers abroad, a matter regulated by Directive 96/71/EC thus reflecting a consensus reached previously at EU level,¹¹⁹ the interpretation of which was precisely at stake.

The hypothesis of a greater deference for diversity in areas where no regulatory competence has been conferred upon or exercised by the Union is further explored hereinafter. Arguably, that deference is the sign of an evolution in the core praxis of the Union toward greater tolerance for the coexistence of varying regulatory standards. It is also consistent with a greater emphasis put on decentralized and/or participative/reflexive policy-making processes, and generally with a pluralist account of the narrative underlying European economic integration. Likewise, it is not excluded that it may be linked to a qualitative evolution in the nature of the questions put to the Court and a greater awareness of the possible implications of its rulings for Member States, including for their resources and, as a corollary, their redistributive powers. Furthermore, it might be construed as a propensity for taking competences (more) seriously in echo to concerns voiced by various national actors over more than fifteen years, and thus as part of a response to challenges over the legitimacy of the Union as a regulatory and political body.

¹¹⁵ As inspired by S. Francq, ‘Note sous C-128/08, *Damseaux*’, *Journ. Drt. Int. (Clunet)*, (2010), 614-615.

¹¹⁶ Case C-341/05, *Laval* [2007] ECR I-11767.

¹¹⁷ *Ibid*, para. 86.

¹¹⁸ *Ibid*, paras. 87-88.

¹¹⁹ Directive 96/71 concerning the posting of workers in the framework of the provision of services [1997] OJ L 18/1.

2. Proportionality Review

As noted, indicia of a possible “turn to pluralism” are more apparent from the proportionality branch of the internal market test, particularly at the level of the equivalence and necessity assessments, which have historically involved an inquiry as to whether the public policy interest pursued by the restriction to trade: (i) is not already satisfied by the rules imposed on the supplier in his country of establishment; and (ii) cannot be achieved by less restrictive means. This is not to say that no development has affected the application of the adequacy portion of the proportionality review. To the contrary, recent case law testifies of a stricter analysis of the “consistent and systematic” character of the pursuit of the alleged justification ground(s). The application of that criterion appears to have been decisive in determining the outcome of various – including prominent – recent cases. For example, in *Rüffert*, the Court of Justice took issue with the fact that the higher rate of pay at issue was deemed necessary to protect construction workers when they are employed in the context of public works contracts but not in the context of private contracts.¹²⁰ In *Corporacion Dermoestetica*, it pointed to the inconsistency of rules prohibiting the advertisement of medical and surgical treatments on national but not on local television networks.¹²¹ Likewise, in the area of establishment, the Court highlighted in *Blanco Pérez* the need to determine whether demographic limitations on the opening of pharmacies sought “in a consistent and systematic manner to ensure that the provision of medicinal products to the public is reliable and of good quality”.¹²² And in the recent stream of gaming cases, emphasis was clearly put on whether restrictions were suitable for achieving objectives, e.g., of consumer protection, “inasmuch as they must serve to limit betting activities in a consistent and systematic manner”.¹²³ In effect, with greater flexibility displayed in the equivalence and necessity inquiries as a result of a higher tolerance for regulatory diversity, the

¹²⁰ Case C-346/06, *Rüffert* [2008] ECR I-1989, para. 40.

¹²¹ Case C-500/06, *Corporacion Dermoestetica* [2008] ECR I-5785, para. 39.

¹²² Joined Cases C-580/07 and C-571/07, *Blanco Pérez and Chao Gomez* [2010] ECR I-not yet published, para. 95.

¹²³ Case C-258/08, *Ladbrokes/Lotto* [2010] ECR I-not yet published, para. 21. See also Case C-42/07, *Liga Portuguesa* [2009] ECR I-, I-7633, para. 61; Joined Cases C-338/04, C-359/04 and C-360/04, *Placanica et al.* [2007] ECR I-1891, para. 53; and Case C-243/01, *Gamballi et al.* [2003] ECR I-13031, para. 67.

test of adequacy has acquired particular prominence in recent years and rose to become a key aspect of the proportionality review, to the point of overshadowing the necessity requirement. The present section endeavours to substantiate that claim.

The starting point of the proportionality review in many recent services cases testifies of a willingness to depart from the fixed objective of Europeanization of regulatory law, that is of promoting at any rate the emergence of a new European majoritarian view aimed to break the path-dependence of actors from national systems.¹²⁴ Thus, in the Italian auto insurance case, for example, the Court of Justice made the following general proposition: “it is not essential, with regard to the proportionality criterion, that a restrictive measure laid down by the authorities of a Member State should correspond to a view shared by all the Member States concerning the means of protecting the legitimate interest at issue”.¹²⁵ That language is clearly reminiscent of *Omega*, where the Court acknowledged that “the specific circumstances which may justify recourse to the concept of public policy may vary from one country to another and from one era to another” and that “it is not indispensable in that respect for the restrictive measure issued by the authorities of a Member State to correspond to a conception shared by all Member States as regards the precise way in which the fundamental right or legitimate interest in question is to be protected”.¹²⁶ In other cases, such as *Liga Portuguesa*, a similar finding to the effect that “[T]he mere fact that a Member State has opted for a system of protection which differs from that adopted by another Member State cannot affect the assessment of the need for, and proportionality of, the provisions enacted to that end” was rooted both in the absence of harmonization at EU level in the field of games of chance with, as a corollary, the freedom “for each Member State to determine in those areas, in accordance with its own scale of values, what is required in order to ensure that the interests in question are protected”, and in the “significant moral, religious and cultural differences between the Member States”.¹²⁷

Interestingly, those considerations displaying a principled tolerance for regulatory diversity are not limited to the area of services, but can also be found in establishment and free movement of goods cases. Thus, in *Blanco Pérez*, already

¹²⁴ See, generally, M. P. Maduro, *We The Court*, above, p. 72.

¹²⁵ Case C-518/06, *Commission/Italy*, above, para. 83.

¹²⁶ Case C-36/02, *Omega* [2004] ECR I-9609, paras. 31 and 37.

¹²⁷ Case C-42/07, *Liga Portuguesa (Santa Casa)* [2009] ECR I- I-7633, paras. 57-58; Case C-258/08, *Ladbrokes/Lotto*, above, para. 19.

discussed, the Court started its proportionality review with the observation that “the fact that one Member State imposes more stringent rules than another in relation to the protection of public health does not mean that those rules are incompatible with the Treaty provisions on the fundamental freedoms” or at least “is not decisive for the outcome of the cases before the referring court”.¹²⁸ Similarly, in the *Italian Trailers* case, the Court of Justice found that “[I]n the absence of fully harmonising provisions at Community level, it is for the Member States to decide upon the level at which they wish to ensure road safety in their territory” and “the way in which that degree of protection is to be achieved”, so that “the fact that one Member State imposes less strict rules than another Member State does not mean that the latter’s rules are disproportionate”.¹²⁹

The immediate consequence of the above premise is, again, the recognition of a “margin of diversity” to Member States in the exercise of their regulatory powers. As the Court stated in *Omega*, again: “the need for, and proportionality of, the provisions adopted are not excluded merely because one Member State has chosen a system of protection different from that adopted by another State”.¹³⁰ At the stage of the proportionality review, however, that margin of diversity translates immediately in the recognition that “[T]he competent national authorities must [...] be allowed a margin of discretion within the limits imposed by the Treaty”,¹³¹ or, stated otherwise, that the diversity of national preferences entails “a margin of appreciation” for Member States.¹³² Even if the sequence of the internal market test embeds by essence a margin of discretion mechanism, providing for an additional national margin of appreciation in those cases characterized by the absence of regulatory consensus at EU level, as translated in EU-wide instruments, and/or in areas marked by profound moral, religious or cultural considerations, discloses the existence of a diversity of review standards and thus the emergence of a pluralist approach to the management of regulatory diversity. As Delmas-Marty observes, “[P]roviding for a national margin of appreciation is the key to ordering pluralism” in so far as “[O]n the one hand, it expresses the centrifugal dynamic of national resistance to integration” and “[O]n the

¹²⁸ Joined Cases C-580/07 and C-571/07, *Blanco Pérez and Chao Gomez*, above., paras. 68-69.

¹²⁹ Case C-110/05, *Commission/Italy (Trailers)* [2009] ECR I-519, paras. 61 and 65.

¹³⁰ Case C-36/02, *Omega* [2004] ECR I-9609, para. 38.

¹³¹ Case C-36/02, *Omega* [2004] ECR I-9609, para. 31. See also, eg., Case C-518/06, *Commission/Italy*, *ibid.*, para. 84 and Case C-258/08, *Ladbroke’s/Lotto*, above., para. 19.

¹³² Case C-110/05, *Commission/Italy (Trailers)* [2009] ECR I-519, para. 34.

other, since the margin is not unlimited but bounded by shared principles, it sets a limit, a threshold of compatibility that leads back to the centre (centripetal dynamic).¹³³ In practice, the grant of an additional margin of appreciation is reflected directly in the operation of the equivalence and necessity inquiries embedded in the proportionality review of national restrictions to cross-border trade.

2.1. Equivalence in question

The possible impact on the operation of the equivalence inquiry of the recognition of a broad margin of appreciation for national authorities is particularly apparent from the series of recent cases involving the gaming/gambling sector. Thus, in the *Placanica* and *Ladbrokes/Lotto* cases, the Court takes as a premise that such margin ought to ensure Member States the freedom of designing “their policy on betting and gambling according to their own scale of values and, where appropriate, to define in detail the level of protection sought”.¹³⁴ In *Liga Portuguesa*, the Court seems to have gone further by suggesting that the margin also ought to affect the implementation of the proportionality test in so far as the latter would then be carried out “solely by reference to the objectives pursued by the competent authorities of the Member State concerned and the degree of protection which they seek to ensure”, thus based on a self-centred perspective focusing on the internal consistency of the domestic system.¹³⁵ In doing so, the Court appears to acknowledge that the public policy interests put forward in support of the restrictions at issue justify a particularly broad margin’s width.

In that context, it is not difficult to anticipate the restrictive interpretation given to the principle of equivalence: “A Member State is therefore entitled to take the view that the mere fact that an operator [...] lawfully offers services in that sector [...] in another Member State, in which it is established and where it is in principle already subject to statutory conditions and controls on the part of the competent authorities in

¹³³ M. Delmas-Marty, *Ordering Pluralism*, above, p. 44. As Delmas-Marty further explains (Ibid, p. 51): “Well understood, a national margin of appreciation is no doubt the best way to avoid simply juxtaposing differences and, instead, progressively rendering practices compatible. ... its use must be rationalised by specifying the conditions that will enable it to order pluralism around shared guiding principles.”

¹³⁴ Joined Cases C-338/04, C-359/04 and C-360/04, *Placanica et al.* [2007] ECR I-1891, paras. 47-48; Case C-258/08, *Ladbrokes/Lotto*, above, paras 19-20.

¹³⁵ Case C-42/07, *Liga Portuguesa (Santa Casa)*, above., para. 58.

that State, is not a sufficient assurance that national consumers will be protected against the risks of fraud and crime”,¹³⁶ as determined by the host Member State in accordance with its “own scale of values”.¹³⁷

Some commentators contend that the above reasoning amounts to a “blanket rejection of the application of the principle of mutual recognition in relation to online gambling services” and “may potentially challenge the whole philosophy underlying [the application of Article 56 TFEU].¹³⁸ Others take the view that the condition of equivalence was simply not fulfilled, notably because of the extreme diversity of domestic legislations in the field of games of chance.¹³⁹ In a recent Opinion, Advocate General Mengozzi sheds some useful light on the tolerance shown by the Court of Justice for the lack of equivalence between the national regulatory frameworks at issue in the above cases.¹⁴⁰ In particular, while acknowledging a departure from the principle of equivalence as formulated in *Säger*,¹⁴¹ he points to the exclusion of the gaming sector from the scope of the Services Directives and to the grant of off-shore gaming licences by the authorities of Malta or Gibraltar as expressions of a lack of mutual trust between Member States in that field, whereas such mutual trust is the precondition for the mutual recognition of gaming licences within the Union.¹⁴² In other words, Advocate General Mengozzi implies that trust cannot be postulated but needs to be translated in operational and effective trust-building mechanisms of a cooperative nature in order to enable mutual recognition and the progressive convergence of national systems.¹⁴³ The link between the management of regulatory diversity and [system] trust is at the core of the attempt to reformulate the inner ethos of European market integration, as provided for in section II, below.

¹³⁶ Case C-42/07, *Liga Portuguesa (Santa Casa)*, above, para. 69 and Case C-258/08, *Ladbroke/Lotto*, above, para. 54.

¹³⁷ Case C-42/07, *Liga Portuguesa (Santa Casa)*, above, para. 57.

¹³⁸ A. Dawes and K. Struckmann, ‘Rien ne va plus? Mutual recognition and the free movement of services in the gambling sector after the *Santa Casa* judgment’, *ELRev.*, 35(2) (2010), 236-262, pp. 259 and 262.

¹³⁹ S. Francq, above, p. 626.

¹⁴⁰ Opinion of Advocate General Mengozzi of 4 March 2010 in Joined Cases C-316/07, C-358/07 to C-360/07, C-409/07 and C-410/07, *Markus Stoß* (available at www.curia.eu, (last visited August 9, 2010).

¹⁴¹ *Ibid*, paras. 95-96.

¹⁴² *Ibid*, paras. 97-98 and 103-104.

¹⁴³ *Ibid*, paras. 100-102.

2.2. Necessity, burden of proof and effectiveness

Affirmations of a greater tolerance for regulatory diversity in cases involving policy areas characterized by the prevalence of domestic preferences over the expression of a consensus at EU level, aim particularly at the operation of the necessity inquiry: “the fact that some Member States have chosen to establish a [regulatory] system different from that introduced by [another Member State...] does not indicate that [the system] goes beyond what is necessary to attain the objectives pursued”.¹⁴⁴ Endowing Member States with an additional margin of appreciation while reviewing the proportionality of public policy justifications for domestic restrictions to trade impacts the necessity inquiry at two levels: (i) the definition of the burden of proof borne by Member States; and (ii) the assessment of the practical constraints faced by Member States in guaranteeing the effectiveness of the protection of the public interest(s) sought. Overall, those developments testify of a relaxation of the necessity inquiry, i.e., of a more lenient assessment compatible with the enhanced discretion left to Member States.

(a) The proof of the absence of less restrictive means

The performance of the necessity inquiry, as the last step in the internal market test, is often perceived as the most extreme form of counter-majoritarianism at EU level and is naturally prone to controversies – who is the Court to second-guess the opportunity of the means set forth by the Member States in pursuance of public policy objectives? In preliminary ruling cases, the Court of Justice leaves to the national court the actual assessment as to whether the domestic rule does not go beyond what is necessary to achieve the objective sought. Yet, it does often provide guidance, more or less subtlety, to its national counterpart, at least as to the level of scrutiny to be exercised and, conversely, the burden of proof incumbent upon the relevant Member State.¹⁴⁵

Precisely, the Court of Justice adopted a particularly deferential position in some recent cases as to the intensity of the burden of proof carried by Member States.

¹⁴⁴ See, eg., Case C-518/06, *Commission/Italy*, above., para. 85.

¹⁴⁵ See, eg., Case C-438/05, *Viking* [2007] ECR I-10779, paras. 87 to 89.

Thus, “whilst it is true that it is for a Member State which relies on an imperative requirement to justify a restriction within the meaning of the [EU Treaties] to demonstrate that its rules are appropriate and necessary to attain the legitimate objective being pursued, that burden of proof cannot be so extensive as to require the Member State to prove, positively, that no other conceivable measure could enable that objective to be attained under the same conditions”.¹⁴⁶ While it is not exactly clear how that standard is supposed to translate in practice, it clearly indicates a willingness to refrain from questioning the means used to implement public policy objectives, to the extent that they appear “adequate”, and the effectiveness thereof.

(b) The effectiveness of the protection of the public interest(s) sought

The second notable evolution in the necessity inquiry associated with the recognition of a margin of appreciation consists in a greater sensitivity displayed toward the effectiveness of the means deployed to ensure the protection of the public interest(s) sought. In the online gaming cases, for example, the Court of Justice pointed to the “substantial risks of fraud” caused by the “lack of direct contact between consumer and operator” to substantiate the practical difficulties for the Member State of establishment to police effectively the practices of games suppliers on a host market and, as a result, to uphold the grant of exclusive rights to operate games of chance via the internet to a single operator, subject to the supervision of its domestic public authorities.¹⁴⁷ This approach is of course evocative of the reasoning adopted by the Court in the *Alpine Investment* case, discussed above, as to the effective means to police cold calling practices.¹⁴⁸ Similarly, in recent free movement of goods cases, the Court also underlined, in its review of the proportionality of prohibition or restrictions on the usage of certain goods, “that Member States cannot be denied the possibility of attaining an objective [...] by the introduction of general and simple rules which will be easily understood and applied [...] and easily

¹⁴⁶ See, eg., Case C-518/06, *Commission/Italy*, above., para. 84 and, for a free movement of goods case, Case C-110/05, *Commission/Italy (Trailers)*, above., para. 66.

¹⁴⁷ Case C-42/07, *Liga Portuguesa (Santa Casa)*, above, paras 69-70 and Case C-258/08, *Ladbroke/Lotto*, above, paras. 54-55.

¹⁴⁸ Case C-384/93, *Alpine Investments*, above, paras. 47-49.

managed and supervised by the competent authorities”.¹⁴⁹ Again, those considerations show a greater deference for Member States’ discretion in devising the means adapted to the satisfaction of the level of protection set in accordance with domestic preferences.

*

The above section has attempted to identify signs of the emergence of a logic of pluralism in the core praxis of the EU system – economic integration, as driven by the ultimate guardian of the unity of the Union, namely the Court of Justice. At this stage, the following conclusion surfaces: in those cases involving indistinctively applicable measures pertaining to policy areas characterized by an absence of EU-wide consensus, as embodied in a legislative instrument adopted at EU level, the Court appears to display a principled tolerance for regulatory diversity,¹⁵⁰ which translates in two interrelated phenomena: (i) a reluctance to proceed to a (re)allocation of regulatory jurisdiction and/or to define regulatory policy; and (ii) the recognition of a broad(er) margin of appreciation to Member State in the exercise of its regulatory powers. In doing so, though, the Court seems to exhibit a preference, at least in the area of services, for a more lenient proportionality review over a limitation of the scope of the notion of restriction to cross-border trade, which remains unsettled but also enables the Court to secure its prerogative of reviewing the opportunity of national regulations and/or to avoid creating safe harbours capable of creating or evolving into loopholes in the EU economic integration system. The above findings call however for three remarks.

First, they are contingent on limitations inherent to the casuistry – i.e., on the nature, scope and timing of particular cases – and, at this stage, remain based on a review of a limited sample of about thirty cases. The ambition is therefore certainly not to express decisive conclusions but to highlight a tendency, which still carries meaning in view of the far-reaching positions held in the past by the Court of Justice, specifically in the field of market integration. The identification of the precise causes

¹⁴⁹ Case C-110/05, *Commission/Italy (Trailers)*, *ibid.*, para. 67; Case C-142/005, *Mickelsson and Roos* [2009] ECR I-4273, para. 36.

¹⁵⁰ Interestingly, it denotes a growing influence of secondary law on the interpretation of primary EU law.

underlying that tendency is a subject for debate; overall, though, they appear to originate in an acknowledgment of existing limits to the interpretation of the market integration provisions of the EU Treaties, possibly informed by past experiences and a greater awareness as to their broad potential in affecting preference (re)formation and the design and implementation of redistributive policies.

Second, the above findings suggest a turn toward a more holistic approach in the application of the market freedom provisions revealing greater attention paid to values other than the trade and, consequently, a willingness to depart from the one-dimensional paradigm of the erosion of national barriers to trade and its corollary, the isolation of the economic and social spheres. As a result, they trigger a fundamental question, that of the transformation of a market-building into a [“market-deepening”] project conditional on mutually-agreed solutions, even if of a cooperative nature. Consequently, wouldn’t that transformation both reveal and require a reformulation of the inner ethos of European economic integration, if not of the matrix of the whole EU system? Part II below explores one possible avenue to address that question.

Third, there is no doubt that protectionist measures remain inefficient and that their removal (will) remain a focus of the economic integration project, yet the above findings reveal the complexity of the notion of efficiency and the difficulty of devising principles capable of harnessing that complexity. The notion of margin of appreciation constitutes an important tool in that respect, in that it allows for a gradation in the intensity of the review of national regulations depending on the nature thereof and policy interests enshrined therein. In essence, the sequence of the internal market test itself embeds a margin of discretion mechanism; hence, by granting Member States an express “margin of appreciation”, the Court of Justice adds in fact width to that original or pre-existing margin of discretion. In turn, the Court reveals a practice of varying and adjusting the margin’s width from case to case, i.e., the existence of a plurality of review standards, and discloses thereby a pluralist approach to the management of regulatory diversity. Such an approach carries great potential but is not immune from risks in terms of legal certainty and thus for the formal validity of the market integration rules. For Delmas-Marty, operating a pluralist approach is indeed dependent on two methodological conditions: “transparency, which requires [international judges] to elaborate on the criteria serving as filters; and discipline, which implies that they respect these filters”. This is an exacting process, in particular on the part of a jurisdiction composed of judges

with very different backgrounds.¹⁵¹ Still, the stakes are high for, according to Delmas-Marty, “judicial transparency and discipline, reasoning and self-limitation are the ingredients for realising the European Union’s motto, ‘united in diversity’”.¹⁵² Moreover, “[C]ommitting to playing this game with determination and discipline” is nothing less than “a way of showing that the union of peoples, including in other regions and at other levels, is not necessarily synonymous with uniformity, and that the universalism of values can adapt to the curves in space and time”.¹⁵³

III. Pluralism, economic integration and the emergence of an ethos of mutual trust

The concept of “economic integration” has been a marking element of post-war economic thinking over trade and international economic relations¹⁵⁴. The concept suffered from an “abundance of mutually contradictory definitions”¹⁵⁵, perhaps because of its dual essence: integration can be conceived of as a process, encompassing “measures designed to abolish discrimination between economic units belonging to different national states”, as well as a state of affairs, represented by “the absence of various forms of discrimination between national economies”¹⁵⁶. Its meaning has been framed by the tensions between the “liberalist” (market friendly)

¹⁵¹ On the impact of the enlargement of the Court of Justice on the articulation of the legal reasoning supporting particular judicial decisions, see M. P. Maduro and L. Azoulay, ‘Introduction’ in: Idem (eds.), *The Past and Future of EU Law*, (Hart Publ.: Oxford/Portland, 2010,) p. xix.

¹⁵² M. Delmas-Marty, *Ordering Pluralism*, above, p. 58.

¹⁵³ Ibid.

¹⁵⁴ On the emergence of the theory of international economic integration see, F. Machlup, *A History of Thought on Economic Integration*, (Macmillan Press, 1977), noting that the term was first employed in business economics. Economists in the inter-war era employed the negative noun of ‘disintegration’ of the world economy, probably as a consequence of the national protectionist legislation that followed the economic crisis of 1929. The positive noun of ‘integration’ was first employed after the Second World War in order to provide a conceptual vehicle for the efforts of “integration of the Western European economy’ the substance of which “would be the formation of a single large market within which quantitative restrictions on the movements of goods, monetary barriers to the flow of payments and, eventually, all tariffs are permanently swept away’ F. Machlup (above, p. 11) referring to Paul Hoffmann’s official pronouncement to the Council of the Organisation of European Economic Co-operation on 31 October 1949.

¹⁵⁵ F. Machlup, *A History of Thought on Economic Integration*, (Macmillan Press, 1977), p. 13.

¹⁵⁶ B. Balassa, *The Theory of Economic Integration* (George Allen & Unwin Ltd, 1961), p. 1. For an extended analysis, see B. Balassa, ‘Towards a Theory of Economic Integration’, *Kyklos* vol. 1 issue 14 (1961), 1-17, p.17-. For a more ‘outcome-oriented’ definition see, J. Tinbergen, *International Economic Integration* (Elsevier, 1954), p. 95, defining integration as ‘the creation of the most desirable structure of international economy, removing artificial hindrances to the optimal operation and introducing deliberately all desirable elements of co-ordination or unification’.

and the dirigist (state intervention friendly) ideals that characterized the political landscape of the post-war era¹⁵⁷.

The development of the twin concepts of negative and positive integration, coined by Tinbergen in 1965¹⁵⁸, and seen as complementary tools to remove discrimination and restrictions of movement in order to enable the market to function effectively, while promoting other broader policy objectives, was seen as a necessary compromise in order to make “economic integration” acceptable to both camps. The different “stages of integration”, identified by Balassa¹⁵⁹, as well as the distinction of the concept of “integration” from that of “cooperation”¹⁶⁰, were also inspired by the same narrative of removing barriers and achieving regulatory sameness to the point that they attracted the criticism that their final stage, the unitary state, was “misconceived” for being inspired “by a centralist rather than federal state model”¹⁶¹. Despite the absence of an authoritative definition of the term, Fritz Machlup noted in 1977 that a wide consensus existed as to the three essential conditions for economic integration: “economic integration refers basically to division of labour”, “it involves mobility of goods or factors”, “it is related to discrimination or non-discrimination in the treatment of goods and factors”¹⁶².

The main difficulty with this conceptualization of integration is that it does not accommodate the need for pluralism and diversity. By bringing in the economics of federalism as an additional analytical tool valuing diversity, economic integration theorists attempted a re-conceptualization of the term that will make it more politically acceptable to the EU member States and to the expected aspirations of the newly formed European citizenry¹⁶³. However, this was a risky analytical venture: once the

¹⁵⁷ Ibid., p. 7-10.

¹⁵⁸ J. Tinbergen, *International Economic Integration* (Elsevier, 1965), p. 76-77. See also Pinder, ‘Positive Integration and Negative Integration: Some Problems of Economic Union in the EEC’, *World Today*, 24 (1968), 88-110.

¹⁵⁹ B. Balassa, *The Theory of Economic Integration*, 1st ed. (George Allen & Unwin Ltd, 1961), p. 2.

¹⁶⁰ B. Balassa, ‘Towards a Theory of Economic Integration’, *Kyklos* 14 (1961), 4-5, indicating that ‘(w)hereas cooperation includes various measures designed to harmonize economic policies and to lessen discrimination, the process of economic integration comprises those measures which entail the suppression of some forms of discrimination’. See also the transformation of the title of Jan Tinbergen’s work to *International Economic Integration* (in 1954) from *International Economic Co-operation* (1945).

¹⁶¹ J. Pelkmans, *European Integration. Methods and Economic Analysis* 3rd ed. (OUP, 2006), pp. 8-9.

¹⁶² F. Machlup, *A History of Thought on Economic Integration*, (Macmillan Press, 1977), p. 14.

¹⁶³ J. Pelkmans, *European Integration. Methods and Economic Analysis* 3rd ed. (OUP, 2006), pp. 11-12. See also the analysis on optimal decision-making in W. Molle, *The Economics of European Integration – Theory, Practice, Policy* 4th ed. (Ashgate 2001), pp. 23-25. The principle of subsidiarity enshrines this economic federalism view that a policy executed at the lowest level of government is

need for diversity brings into the concept of economic integration a broader set of values than the more instrumental one of removing barriers to exchange, the concept loses its distinctive character and becomes confined to that of efficiency (broadly defined as the satisfaction of preferences of the different units of the entity). The question then boils down to identifying a measure of success for this kind of “economic integration”. One could possibly imagine integration as a continuous and never-ending process of balancing of the different interests in presence (integration as a process) but such a concept of integration will be devoid of purpose and thus semantically empty, not to mention unfit from a policy prescription perspective.

One could turn instead to study institutions of governance, under the assumption that they may provide useful insights as to the interaction between the process of economic integration and the concept of pluralism. In that regard, the development of legal rules and informal arrangements in the EU can be viewed as part of a broad effort to mitigate the risks generated by the existence of interaction and interdependence between different regulatory systems. The more diverse the regulatory regimes are, the higher the risks involved. The process of managing these risks leads to the emergence of various governance mechanisms or tools, which present discrete characteristics.

Trade in services is probably the area where more differences lay across the regulatory regimes of EU Member States, as a result of the recent liberalisation of the sector and the lack of expansive enforcement of the negative integration rules. It is also the area where the application of the principle of the freedom of movement led to the emergence of various governance mechanisms that defy the paradigm of positive (harmonization) versus negative integration (market access principle or national treatment). The hypothesis defended in this study is that the existence of a variety of governance mechanisms may be explained by the need to manage regulatory pluralism.

This analytical step becomes possible if we embrace a new paradigm of integration based on the concept of trust. To support this theory, one could note the revolution brought to the conceptual edifice of “economic integration” by the principle of “mutual recognition”, a major innovation introduced by the European judiciary in

thought more efficient because of higher participation, a greater ability to observe preferences, a higher degree of accountability and greater incentives for regulatory experimentation.

Cassis de Dijon. Perceived initially as a tool of negative integration working alongside the broad “obstacles to trade” approach in defining restrictions of trade, the principle of mutual recognition has evolved towards a mechanism of re-allocation of jurisdictional authority, “a hybrid at the intersection of both processes” (market access and harmonization)¹⁶⁴. Based on mutual trust, among regulators, mutual recognition has become since the “core paradigm” of “economic integration”, the “starting assumption” before determining the need for “a policed national treatment” or “harmonization”¹⁶⁵. This evolution displaces the uni-dimensional focus of integration theory on the erosion of barriers to exchange that underpinned the dilemma between negative and positive integration. Mutual recognition defies this paradigm and suggests a different perspective on economic integration, conceived of as a process of building increased levels of “institutional-based” trust (or “system trust”) between actors interacting across national boundaries. The emphasis on the constitutive element of trust integrates some degree of marginalist thinking in integration theory that contrasts with the overall significance the classic economic integration theory accords to the erosion of barriers to exchange, to the point that the different stages of integration are conceived as a *continuum* going from the existence of barriers (and the resulting pluralism of regulatory cultures) to the absence of barriers to trade (and the resulting uniformity of the single market).

¹⁶⁴ K. Nicolaidis, ‘*Mutual Recognition of Regulatory Regimes: Some Lessons and Prospects*’, Jean Monnet Working Paper, (1997), available at <http://centers.law.nyu.edu/jeanmonnet/papers/97/97-07.html>, § 13 (last visited September 20, 2010).

¹⁶⁵ *Ibid.*, at § 16.

A.The emergence of discrete governance mechanisms

Governments regulate their economies for various reasons as explained by public interest, interest group or capture theory of regulation¹⁶⁶. According to the principle of territoriality, these domestic policies apply to the territory controlled by the host Member State and affect any economic operator that is economically active in its jurisdiction. The group of affected economic operators is not only limited to domestic service-providers but also extends to foreign service-providers that offer their services in the host Member State. Domestic policies will thus produce some form of extraterritorial effect, in particular as service-providers established in other Member States (home State) may incur increased costs, as a result of the regulation imposed by the host State. First, the regulation of the host State may affect the objectives pursued by the home State to have access (for the benefit of economic operators established in its territory) to the host State's market. Secondly, the regulation of the service-providers by the home State might affect the policy goals of the host State, as long as the foreign service-providers established in the home State have access to the host State's market and the host State's regulation is rendered ineffective by the fact that some economic operators are established outside its jurisdiction. Indeed, it is theoretically possible for each State to adopt unilaterally measures in order to mitigate the negative externalities to its domestic policies generated by foreign service-providers. However, in some circumstances this is not possible, for example because of the important costs of monitoring economic operators established outside its own jurisdiction or the ineffectiveness of controls, or even desirable, from a policy perspective. In these instances, cooperation with the foreign jurisdiction would be more effective in order to deal with these negative policy externalities.

It follows that the existence of negative domestic policy externalities that have cross-border effects constitutes the main reason for the emergence of a situation of cooperation between States. Moravscik observes that

“(n)ational governments have an incentive to co-operate where policy coordination increases their control over domestic policy outcomes, permitting them to achieve goals that would not otherwise be possible. This situation

¹⁶⁶ For an introductory analysis see, R. Baldwin and M. Cave, *Understanding regulation* (Oxford University Press, 1999).

arises most often where co-ordination eliminates negative international policy externalities”¹⁶⁷.

In contrast, positive policy externalities, that is policies that confer benefits on foreign groups in order to promote domestic policies, are often of little interest for international trade agreements or regimes,. The “purely internal situation” case law of the ECJ for restrictions of trade that disadvantage nationals¹⁶⁸ provides a good illustration of this lack of interest to positive cross-border externalities. The explanation is simple and relates to the absence of an incentive to cooperate in a situation of positive policy externality: “(o)nly where the policies of two or more governments create negative policy externalities for one another, and unilateral adjustment strategies are ineffective, inadequate or expensive, does economic interdependence create an unambiguous incentive to co-ordinate policy”¹⁶⁹.

By entering in cooperation with other States, the host States incur risks. Cooperation is often initiated by conditional promises by which each State declares that it will act in a certain way under the condition that the other State acts in accordance to its own commitments. This relation of reciprocity may take different forms. Bilder explains,

“(i)n general, a nation’s decision to enter into an international (cooperation) [...] can be said to involve considerations of risk when that nation believes that its commitment to the (cooperation) [...] may, depending on the occurrence or non-occurrence of particular future events or outcomes as to which it is uncertain or in doubt, expose if to an eventual final outcome which is harmful in that its costs exceed its benefits. Typically, risk will be thought of in terms of probabilities”¹⁷⁰.

According to the same author, States may be concerned by one of the following broad types of risk:

¹⁶⁷ A. Moravcsik, ‘Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach’, above, p. 485.

¹⁶⁸ See, for instance, Case C-212/06, *Government of the French Community and Walloon Government v. Flemish Government* [2008] ECR I-1683, para. 38. For an analysis see, AlinaVTryfonidou, ‘The Outer Limits of Article 28 EC: Purely Internal Situations and the Development of the Court’s Approach Through the Years’, in: C. Barnard and O. Odudu (eds.), *The Outer Limits of EU Law* (Hart Pub.: Oxford, 2009), pp. 197-243.

¹⁶⁹ A. Moravcsik, ‘Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach’, above, p. 486.

¹⁷⁰ R. B. Bilder, *The Role of Trust in International Agreement*, (Mimeo, Fall 1979,) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=912741 , p. 7 (last visited September 20, 2010).

“(1) The risk that the nation may later decide, for extraneous reasons, that it no longer wishes to participate in the agreement. For example, it may wish to get out of the agreement because some other nation has offered it a “better deal”.

(2) The risk that the intrinsic utility of the agreement to that nation may decline to the extent that the prospective benefits from the agreement no longer equal or exceed its costs. For example, the cost of performing its promise may increase or the value of what it has been promised may decline;

(3) The risk that the other nation concerned may not perform as promised. For example, a nation’s treaty partner may completely withhold performance or may “cheat”¹⁷¹.

The existence of risk will require recourse to various risk management techniques, such as “provisions for easy withdrawal (from the mutual commitments), guarantees, timing of performance, verification and inspection, escrow, hostage, buffer zones, dispute settlement, sanctions”...¹⁷² One could envision these different risk management techniques as forms of regulation of risk. The term regulation should not be perceived in its usual hierarchical dimension, in opposition to voluntary forms of governance such as networks, but as involving some form of action on the variables generating risk with the intention to manage uncertainty. The types of risks involved, the fact that the State will be risk-averse or risk-prone, the availability of information about the partner, the probability of occurrence of the risks or the existence of important opportunity costs in case of non-cooperation would impact on the choice of the institutional alternative to manage risk, and thus on the governance mechanism of the particular cooperative relationship.

In the context of a cooperation aiming to mitigate negative domestic policy externalities with cross-border effects, different governance mechanisms will emerge. It has been argued that there are three main institutional alternatives or governance mechanisms to manage risk in international trade law¹⁷³.

The first is the mutual commitment not to employ specific types of domestic regulation (a negative obligation). The conditional promises of the States may relate

¹⁷¹ Ibid, p. 8.

¹⁷² Ibid, p. 11.

¹⁷³ S. Schmidt, ‘Mutual recognition as a new mode of governance’, *JEPP*, vol. 14 issue 5 (2007), 667-681, p. 671.

to the implementation of a national treatment rule. The latter prevents either State (home and host) from applying discriminatory standards to cross-border services; the State is otherwise free to set any standard that is not directly discriminatory to the foreign service-providers.¹⁷⁴ In the field of services, the ECJ moved progressively to expand the conditional promise of non-discrimination (or the application of a national treatment rule) to include a market access rule¹⁷⁵, where States commit not to adopt regulation that would affect the market access of foreign service-providers and establish barriers to trade, whatever that term means¹⁷⁶. The starting point for both these rules is the existence of some form of negative cross-border domestic policy externalities. As noted, these arise “where the policies of one nation impose costs on the domestic nationals of another¹⁷⁷, thereby undermining the goals of the second government’s policies”¹⁷⁸. The main difference between the principles of national treatment and that of market access is the type of international negative domestic policy externalities that are of normative and practical interest, for the application of the prohibition principle. If, as it seems to be the case in the EU, the normative framework of the cooperation aims to achieve “the elimination of all obstacles to intra-community trade in order to merge the national markets into a single market bringing about conditions as close as possible to those of a genuine internal market”¹⁷⁹, anything causing a potential disparity between legal orders and thus different economic conditions would be of interest to define the cross-border negative domestic policy externalities that will be the focus of the prohibition rule. In theory, the list of prohibited practices can include different domestic environmental pollution standards or other regulatory barriers imposing costs on cross-border service provision, competitive devaluation and different employment conditions leading to higher or lower labour costs, irrespective of the fact that the same rules apply to domestic firms.

¹⁷⁴ K. Nicolaidis and G. Shaffer, ‘Transnational Mutual Recognition Regimes: Governance without Global Government’, *Law and Contemporary Problems*, 68 (2005), 263-317, p. 267.

¹⁷⁵ Case 76/90 *Säger v Dennemeyer* (1991) ECR I-4221, para. 12.

¹⁷⁶ On the different interpretations of this concept, see the analysis in I. Lianos, ‘Shifting Narratives in the European Internal Market: Efficient Restrictions of Trade and the Nature of “Economic” Integration’, *EBLR*, 21(5) (2010), 705.

¹⁷⁷ Here we will assume that the concept of non-nationals refers to foreign service-providers or cross-border services providers.

¹⁷⁸ A. Moravcsik, ‘Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach’, *JCMS*, vol. 31 issue 4, (1993) 473-524, p. 485.

¹⁷⁹ Case 15/81 *Schul* [1982] ECR 1409, para. 33.

Cooperation (in the form of a mutual commitment to a market access rule) can be particularly difficult to reach in situations where the governments have divergent policies, because of the different preferences to which they have to respond in the domestic arena. The variety of preferences translates a different mix of societal interests, power struggles and bargaining positions between interest groups and the existence of a plurality of institutional structures across societies reflecting these interests. The objective of inter-state cooperation becomes thus to find a way to internalize negative policy externalities, that is, to restrain the domestic interests that affect foreign service-providers and to devise an optimal division of the burden of adjustment. Cooperation emerges when the costs of co-ordination are outweighed by the common interest in reducing negative policy externalities (for example when cooperation generates gains to powerful interest groups, if one adopts the capture or public choice theory of regulation, or more generally to the public interest, in conformity with the public interest theory of regulation)¹⁸⁰.

Second the market access rule can be distinguished from the national treatment rule by focusing on the degree of internalization of cross-border negative domestic policy externalities. National treatment allows for the achievement of the goals of domestic policy, as long as this does not lead to a discrimination against cross-border service providers. Thus, a national treatment rule does not internalize all negative policy externalities, as cross-border service-providers will still incur the costs of conforming to a different regulatory structure. In comparison, a broad market access rule has less potential to achieve the goals of domestic policies, but enables the internalization of negative externalities to a higher degree, as national rules are prohibited whenever they impose barriers to the market access of cross-border services. There are various interpretations of the concept of trade barriers, but whichever is adopted, the scope of the prohibition rule is broader than under the national treatment rule.

Because of its potential breadth, with regard to the type of domestic regulations that it brings within its scope, the application of a pure market access rule is not politically achievable or even desirable in the EU. First, not all barriers to trade fall within the scope of the EU market access rule. For example, competitive devaluation

¹⁸⁰ A. Moravcsik, 'Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach', above, p. 492.

is not prohibited for countries that do not participate to the Eurozone and the regulation of labour markets is largely outside the realm of the negative integration provisions of the Treaties. Second, EU Member States may restrict the freedom to provide cross-border services if this is justified by various recognised public interest objectives which are not protected by the home state's regulation to the same standard (efficient restrictions of trade)¹⁸¹. Should this be the case, the host State's regulation will apply, subject to the proportionality principle. The latter will uncover situations of opportunistic behaviour, where the State would be arguing a public interest justification with protectionist intent. Should this public interest justification prove successful, following judicial assessment, the host member state may maintain measures that are restrictive of trade. The application of the market access rule is therefore conditioned by specific circumstances, in particular the absence of a legitimate justification for the restriction of trade. We will refer to this principle as "conditional market access".

The possibility of exceptions to the application of the market access rule, offered to the host State, is further qualified in the EU by an asymmetrical allocation of the burden of proof between the home and host State that disfavours the host State. This is achieved by the principle of equivalence, which creates a presumption that the home State's regulatory system internalizes all the cross-border negative policy externalities that it produces. It is on the host State to prove that this is not practically the case, for example because of some fundamental differences, which may relate to diverse regulatory cultures and policies determining mutual perceptions of regulatory effectiveness, different risk assessments, or more broadly the absence of "regulatory compatibility" between the two regimes¹⁸². The principle of equivalence attenuates the possible neutralisation of the market access principle by a frequent and inconsiderate use of exceptions. It constitutes a form of mutual recognition, as, by convening that their relations are governed by this principle, the home and the host state mutually recognize the compatibility of their regulatory systems.

The principle of equivalence constitutes thus a discrete governance mechanism compared to the market access and national treatment rules, as it involves a positive

¹⁸¹ I. Lianos, 'Trust, distrust and economic integration: efficient restrictions of trade and the evolution of the law of the Internal market', *UCL Global Law Research Paper Series* (forth. 2011).

¹⁸² K. Nicolaidis and M. Egan, 'Transnational market governance and regional policy externality: why recognize foreign standards?', *JEPP*, vol. 8 issue 3, (2001) 454-473, p. 458.

obligation imposed to the host States to “recognize” the regulatory system of the home State. This involves a presumption of equivalence of the preferences maximised by the home State’s regulation to those satisfied by its own regulation that is attached to it.

The practical assessment of the application of the equivalence principle is often left to a third independent party, the courts. As it is rightly observed by Maduro, the courts do not assess whether the different national legislations are identical¹⁸³. The principle of equivalence, operating as a presumption dismisses the need to integrate this assessment in the judicial control. What the courts can do, however, is to define the negative policy externalities to foreign interests that need to be internalized for the principle of equivalence to operate fully.

Here, opinions diverge. Some authors argue that the role of the courts is to ensure the “virtual representation” of all foreign interests that might be affected¹⁸⁴. It follows, that courts, such as the European Court of Justice, will not simply look to the regulatory compatibility of the home and host states’ regulations, but will impose a solution which introduces the “EU interests of market integration in the national decision-making process”¹⁸⁵. This definition of the principle of equivalence requires from the Courts to intervene in order to virtually represent all the omitted foreign interests. This can take either the form of a proper balancing test that will *evaluate* the local benefits and the foreign costs and then assess their respective weight, or an “institutional malfunctions” test¹⁸⁶.

Other authors question the premises of the “virtual representation” argument and advance instead a “local/global equivalence” argument¹⁸⁷. According to this view,

¹⁸³ M. P. Maduro, ‘So close and yet so far: the paradoxes of mutual recognition’, *JEPP* vol. 14 issue 5 (2007) 814-825, p. 821.

¹⁸⁴ M. P. Maduro, *We The Court – The European Court of Justice and the European Economic Constitution* (Hart Pub.:Oxford, 1998), p. 170. The assumption of the virtual representation argument is that in the national political process, foreign interests are not usually taken into account, as they are not adequately represented. This might lead to a Kaldor-Hicks inefficiency, in particular when the foreign costs are greater than the local benefits of the regulation or when the foreign costs are excessively more important than the local benefits. For example, an environmental regulation might impose high costs to some foreign producers in order to satisfy the preferences of local consumers for a cleaner environment. The assumption is that the production of the foreign good has negative externalities on the host state’s environment

¹⁸⁵ M. P. Maduro, ‘So close and yet so far: the paradoxes of mutual recognition’, above, p. 821.

¹⁸⁶ M. P. Maduro, ‘Reforming the Market or the State? Article 30 and the European Constitution: Economic Freedom and Political Rights’, *ELJ*, vol. 3 issue 1 (1997), 55-82.

¹⁸⁷ D. H. Regan, ‘Judicial Review of Member-State Regulation within a Federal or Quasi-Federal System: Protectionism and Balancing. ‘da Capo’, *Michigan L Rev* vol. 99 issue 8 (2001), 1853-1902, pp. 1859-1860.

foreign interests are often accounted for by local interests in decision-making. The interests of the local consumers might indeed be affected by a regulation that favours local producers and harms foreign producers/suppliers. But a strict environmental regulation that is indistinctly applicable will also affect local suppliers of products whose production is not compatible with the stricter environmental standards and who might be either obliged to increase their costs considerably and thus lose market share or to exit the market. It might also affect local consumers that are unable to buy the more expensive environmentally-friendly products. These local interests will oppose their home state's regulation, as its effect will decrease their welfare, and by doing so, they will represent the foreign interests in the domestic political process. In other words, there is a vicarious consideration of the foreign producers' interests by the integration in the analysis of local consumers' and/or some local suppliers' interests.

The assumptions about the internalization of cross-border negative domestic policy externalities being exactly the opposite, each theory leads to a different degree of discretion for national regulatory systems and *in fine* to a different end-point in their interaction. The virtual representation argument theory will be vindicated if, through the judge's intervention, the regulation under examination will internalize all the negative policy externalities of a domestic regulation to foreign interests: in other words foreign interests will be integrated by judicial decision to the domestic weighing of interests, thus breaking the boundary between foreign and domestic interests: the "foreign" and the "domestic" sphere becoming one. In contrast, the local/global equivalence theory will internalize some negative policy externalities to foreign interests, presumably only those accounted for by local interests. The distinction between foreign and domestic will thus still be relevant, as it is possible that a different weighing of interests develops across jurisdictions, depending on the bargaining power of the various societal interests. As a result, there would be regulatory diversity, not sameness.

A third institutional arrangement/governance mechanism to deal with risks is for the parties to the cooperation to agree on common rules/standards of protection across jurisdictions, in other words to write a contract, implemented by a third party, which remains outside the control of the home or the host State. We thus move from regulatory compatibility to regulatory sameness or regulatory harmonization, at least as far as regulatory values are concerned. The same rules apply to all jurisdictions.

Harmonization is the preferred governance mechanism where the national treatment or market access principle cannot be enforced successfully. This may be caused from the fact that there are significant differences between the regulatory values of the home and the host States, which cannot be resolved on a case by case basis by the courts applying the market access rule or the principle of equivalence. There are various reasons for this. Courts may not have the legitimacy or the power to resolve the distributional conflicts between the winning and the losing societal interests in the home and host state, the task being delegated to the political process. The application of the market access rule may be unsuited for sectors subject to technically complex regulation that requires an important amount of information and continuous supervision of the service provider. Furthermore, if there is economic interdependence between the jurisdictions, there is a high occurrence of cross-border negative policy externalities. In this case, harmonization may reduce transaction costs. Transaction costs include “the cost of collecting information on the amount of welfare benefits¹⁸⁸” the home or the host state might gain in order to determine their position as to the internalization of negative policy externalities in each case following the application of the market access rule. It also involves the costs of the *ad hoc* judicial examination of the justifications proffered by the State or the application of the principle of equivalence. The choice of harmonization as the adequate institutional framework will thus be a function of the comparison between these transaction costs and the costs entailed by harmonization¹⁸⁹.

¹⁸⁸ J. P. Trachtman, *The Economic Structure of International Law* (Harvard Univ. Press 2008), p. 10

¹⁸⁹ These harmonization costs might be of different sorts. First, the costs related to the bargaining game over the terms of co-operation, secondly, ‘agency costs’, thirdly costs of ‘mutual spying’: see, K. Nicolaidis, ‘Kir Forever? The Journey of a Political Scientist in the Landscape of Mutual Recognition’, in M. Maduro (ed.), *The Past and Future of EU Law; The Classics of EU Law Revisited on the 50th Anniversary of the Rome Treaty* (Hart Pub. 2010) 447, p. 453. It is obvious that the harmonization process requires an immense effort of identifying, negotiating and enforcing bargains, which might be achieved through side-payments and linkages. Costs may also rise by the strategic behaviour of parties aiming to gain a better bargain (than the other) with regard to the distributional consequences of the arrangement. Communication between the states and collection of information about the partners may also be costly. In the EU context, these costs are relatively minor, as the environment in which EU governments bargain is ‘relatively information-rich’, ‘national negotiators are able to communicate at low cost and possess information about the preferences and opportunities facing their foreign counterparts, as well as the technical implications of policies that are of the greatest interest to them’: see, A. Moravcsik, ‘Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach’, above, p. 498. Finally, agency costs arise usually after the negotiations have been concluded and refer to the principal/agent relation between the states (principal) and the institution (agent) they designed to monitor and enforce their agreement. For example, the agreement may not be enforced at the desired (by the agents) level. In the presence of a decentralised enforcement of the common standards, the monitoring process involves ‘mutual spying’

However, the existence of discrete institutional alternatives cannot be limited to the principles of (pure) market access (national treatment), (conditional) market access (principle of equivalence) and harmonization. The terminology of “mutual recognition” that now dominates the discourse about governance of economic integration projects indicates that those different institutional alternatives form part of a *continuum*,¹⁹⁰ which can be further creatively expanded with the emergence of new forms of governance, building on these foundational blocks.

There are various forms of “mutual recognition”. Some authors, like Pelkmans, oppose “judicial mutual recognition” to “regulatory mutual recognition”¹⁹¹. Whilst “judicial mutual recognition” proceeds to an *ad hoc* and *ex post* assessment of State measures, depending on the individual cases brought to the courts, “regulatory mutual recognition”, relies more on a systematic scrutiny of existing measures, by means of a screening mechanism, early warning systems (including the obligation to notify new measures), administrative cooperation among national authorities and mutual evaluation procedures, thus falling sort of the rigidity of the “harmonization” conceptual category. Mutual recognition can thus be perceived as a form of “new governance” mechanism¹⁹². “New governance” was an appropriate catch-all slogan to conceptualize the unlikeness of the “new” “regulatory mutual recognition” to the more established “harmonization” category. By emphasizing the soft and somehow more collaborative and voluntary, rather than hierarchical and binding character of the former¹⁹³, its ambition was to describe a new phenomenon rather than to provide categorical and conceptual clarity. There was no attempt to advance and test explanations on the causes of this shift from old to “new” governance methods that

from each of the parties to the agreement in order to identify instances of cheating and put in place the right counter-strategies. This can take the form of the establishment of networks involving personnel from all parties to the agreement ensuring a form of monitoring, regular meetings between the parties, exchange of information, the development of appropriate sanctions in case of cheating, such as strategies to increase reputation costs, in other words all conditions that favour the maintenance of the cartel between them.

¹⁹⁰ K. Nicolaidis & Gregory Shaffer, ‘Transnational Mutual Recognition Regime: Governance without Global Government’, *Law & Contemporary Problems* 68 (2005), 263-317.

¹⁹¹ J. Pelkmans, ‘Mutual recognition in goods. On Promises and disillusion’, *JEPP* vol. 14 issue 5, (2007) 699-716.

¹⁹² S. Schmidt, ‘Mutual recognition as a new mode of governance’, *JEPP* vol. 14 issue 5, (2007), 667-681.

¹⁹³ G. de Burca and J. Scott, *Law and New Approaches to Governance in the EU and US* (Hart Pub.: Oxford, 2006); J. Scott and D. M. Trubek ‘Mind the Gap: Law and New Approaches to Governance in the European Union’, *ELJ* 8 (2002) 1-18; K. Armstrong and C. Kilpatrick, ‘Law, Governance or New Governance? The Changing Open Method of Coordination,’ *Columbia Journal of European Law* 13 (2007) 649-677.

would have led to informed predictions on the evolution of EU governance in various fields

May be, this is due to the fuzziness of the “mutual recognition” category. As Poiaras Maduro once noted, the principle of mutual recognition conceals a dual nature¹⁹⁴. First, it may constitute a governance mechanism, in the sense that it generates a process of regulatory competition and decentralisation that can be distinguished from harmonization¹⁹⁵, as previously explained. Secondly, it operates as a conflict of law rule. Wolfgang Kerber with Roger van den Bergh have convincingly argued that mutual recognition aims to delineate the regulatory powers of jurisdictions and to test whether the traditional national regulatory autonomy is still defensible or if decentralization should be replaced by another allocation of regulatory powers that can either take the form of “centralization (including measures of harmonization) or a free market for regulations (free choice of law)¹⁹⁶. As a conflict rule that determines which governance mechanism will prevail it cannot be a form of governance in itself¹⁹⁷.

Indeed, some formulations of the mutual recognition principle may lead to the extraterritorial application of the home State’s law, thus providing economic operators with a limited right to choose among different national regulatory regimes. The application of a country of origin principle, where the host State accepts without any conditions the regulatory standards of the home State (pure mutual recognition) can lead initially to a system of intense regulatory competition between States, as economic operators are free to experiment with different regulatory systems. A country of origin principle may thus be compared to a uniform choice of law rule, where the applicable regulatory standards are always those of the home state, notwithstanding the fact that the practice affects the host state’s domestic interests. The extraterritorial application of the home state’s law that results from the country of origin rule increases the likelihood of a race to the bottom, where different regulatory systems enter in a spiral of scaling down their mandatory requirements in order to improve their position in the regulatory competition game. Ultimately, this might lead

¹⁹⁴ M. Maduro, ‘So close and yet so far: the paradoxes of mutual recognition’ *JEPP* vol. 14 issue 5, (2007) 814-825, 815.

¹⁹⁵ S Schmidt, ‘Mutual recognition as a new mode of governance’, above, p. 667.

¹⁹⁶ W. Kerber and R. Van den Bergh, ‘Mutual Recognition Revisited: Misunderstandings, Inconsistencies, and a Suggested Reinterpretation’, *Kyklos* 61 (2008), 447-465, 448.

¹⁹⁷ M. Maduro, ‘So close and yet so far: the paradoxes of mutual recognition’, above, p. 815.

to a unification of law and to harmonization, where the most “competitive” regulatory standard will prevail. Conflict of law rules can easily become instruments of harmonization and integration¹⁹⁸.

The decision to adopt choice of law as the optimal means of allocating regulatory competences between member States is based on the assumption that a market for regulation will effectively satisfy the various regulatory preferences. However, a market for regulation may generate externalities, the race to the bottom being an obvious example. The provision of a free menu of regulatory options to economic operators would in this case not satisfy some domestic interests favouring high quality of services, safety, consumer protection or environmental standards. These values may not be taken into account by the market mechanism, because the total gains to be made by satisfying the marginal consumers of regulation (foreign entrepreneurs) and some infra-marginal consumers of regulation (domestic interests favouring low prices) will be more important than the costs to infra-marginal consumers of regulation (domestic interests – consumers and entrepreneurs- valuing environmental protection, consumer protection, social welfare) that put these values higher than lower prices in their scale of preferences. A mandatory allocation of regulatory competences would be an option in this case. The decision-making may be (i) exclusively delegated to a third-party, (ii) shared between the affected jurisdictions, (iii) permanently delegated to one of them, home or the host State. The country of origin principle may be perceived as an example of the third option, the regulatory competence being exclusively exercised by the home State. It does not thus constitute a free menu choice of law system. One could certainly theoretically envision a country of the provision of services option, where regulatory competence will only be exercised by the host country and not by the home jurisdiction (for services that are cross-border). Such an option faces practical difficulties, because of the principle of territoriality in regulation and the difficulty to distinguish *ex ante* between services that are provided cross-border, where the home state’s regulatory regime will not apply, and services destined for the domestic market. There are also options (i) and (ii), which broadly correspond to the governance mechanism of harmonization and that of “managed mutual recognition”, where the parties to the

¹⁹⁸ P. Hay, O. Lando and R. D. Rotunda, ‘Conflict of Laws as a Technique for Legal Integration’, in: M. Cappelletti, M. Seccombe and J. Weiler (eds.) *Integration Through Law – Vol. 1, Book 2* (Walter de Gruyter, 1986), p. 161.

cooperation framework share the regulation of risks by effectively ensuring that negative cross-border policy externalities are internalized through mutual understandings concerning the required adjustments of the burden.

With this conceptual framework in mind, the next section explores the regulation of trade in services in the EU and the different governance tools chosen for various sectors, with the view to highlight the emergence of hybrid governance tools that challenge the established conceptual categories of national treatment, market access and harmonization. The hypothesis is that this variety of governance tools exemplifies the efforts made in the EU to accommodate regulatory pluralism.

B. A variety of governance tools in the area of services: adjustment to accommodate legal pluralism?

The area of the free movement of services constitutes an interesting natural experiment for testing this proposition. Governments regulate trade in services for a number of reasons: they may be motivated by the need to promote the provision of some services in the marketplace that, absent regulation, would have never been provided, they may want to address externalities arising from the existence of natural monopolies or relational bargaining power because of an informational asymmetry, they may have paternalistic concerns or pursue aims of distributive justice. The scope of negative policy externalities that are of concern for EU law is also broad, the market access rule operating under Article 56 of the TFEU covering all measures that have the potential to affect cross-EU trade. Consequently, the governance arrangements dealing with these negative externalities may swathe various sectors of the economy and affect large societal interests.

1. The exclusion of the full operation of the principle of equivalence: the example of gambling

As noted, the Court of Justice recognized in *Liga Portuguesa* the need for Member States to develop their own scale of values with regard to the application of paternalistic regulation in order to preserve social objectives or to reduce criminal

activity¹⁹⁹. The fact that the Council has put in place a Working Party on Establishment and Services on the legal framework for gambling and betting, which provided extensive information on the legal regime of the different Member States in this area might explain the cautious approach followed by the Court. After all, it was clearly explained in the progress report published by the Swedish presidency that Member States should be free “to set the objectives of their policy on betting and gambling and, where appropriate, to define in detail the level of protection sought”²⁰⁰

The Court could have applied the principle of equivalence as for all cases where Community harmonization has not been adopted. It chose instead a different starting point, that of the regulatory diversity of Member States. As explained in section I.B.2 above, the result is that the burden of proof in proffering public policy justifications for measures restricting market access is now profoundly altered. Host States could dismiss an allegation of an Article 56 TFEU infringement by emphasizing the diversity of their regulatory regime: the once feared proportionality test is now to be carried out “solely by reference to the objectives pursued by the competent authorities of the Member State concerned and the degree of protection which they seek to ensure”²⁰¹.

This case exemplifies the emergence of a special category of judicial mutual recognition where the principle of equivalence does not operate, as it usually does under the framework established of the ECJ in *Cassis de Dijon*. This is not with the intention to promote gambling as an area of regulatory experimentation for Member States before making the choice of a more centralized or federal regulatory option.

¹⁹⁹ Case C-42/07, *Liga Portuguesa de Futebol Profissional v. Departamento de Jogos sad Santa Casa da Misericórdia de Lisboa* [2009] ECR I-7633, para. 69, ‘[...]’ it should be noted that the sector involving games of chance offered via the internet has not been the subject of Community harmonisation. A Member State is therefore entitled to take the view that the mere fact that an operator [...] lawfully offers services in that sector via the internet in another Member State, in which it is established and where it is in principle already subject to statutory conditions and controls on the part of the competent authorities in that State, cannot be regarded as amounting to a sufficient assurance that national consumers will be protected against the risks of fraud and crime, in the light of the difficulties liable to be encountered in such a context by the authorities of the Member State of establishment in assessing the professional qualities and integrity of operators’.

²⁰⁰ See, Council of the European Union, Swedish Presidency Progress Report, Legal framework for gambling and betting in the Member States of the European Union, 25 November 2009, available at <http://register.consilium.europa.eu/pdf/en/09/st16/st16571.en09.pdf> at ¶13; See also, Council of the European Union, Conclusions on the framework for gambling and betting in the EU Member States, 10 December 2010, available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/intm/118398.pdf noting the regulation of the gambling sector by national regulatory authorities and suggesting cooperation between them.

²⁰¹ Case C-42/07, *Liga Portuguesa (Santa Casa)*, above, para. 58.

The objective is clearly to accommodate the variety of societal choices across the Member States in the Union.

2. Delegation to the private sector and self regulation (codes of conduct)

In other instances regulation establishing barriers to trade is necessary to deal with market failure. Depending on which services sector comes into focus, the extent of regulation varies. Several factors such as increasing risks or the nature of the industry involved can determine the form of governmental action. In the sector of professional services, it might be necessary to maintain high professional standards and to ensure the quality of services for the benefit of the consumers. This regulation, pervasive in some economic sectors, is not always directly the fact of the State. It may emanate from a number of private professional associations/bodies to which the State has delegated the power to regulate professions. The definition of quality standards and other requirements for the exercise of professions is a highly information intensive task, requiring an expert knowledge of the social and economic context of the profession, the expectations of consumers, the existing social (informal) norms that govern the exercise of professions (reputation effects). The reality of the regulatory space is complex enough, rendering improbable the choice of a simple command and control regulatory instrument. The self-regulation of professions complicates also any effort of harmonization at the EU level. The traditional harmonization tools would have not adequately addressed the plurality of actors and interests represented in the regulation of the professions in the various Member States. A different mechanism had thus to be chosen: European-wide codes of conduct.

According to Article 37 of the Services Directive,

“(m)ember States shall, in cooperation with the Commission, take accompanying measures to encourage the drawing up at the Community level, particularly by professional bodies, organisations and associations, of codes of conduct aimed at facilitating the provisions of services or the establishment of a provider in another member State, in conformity with Community law.

This bottom-up approach emphasizes the involvement of the private sector and professional organizations/bodies across the Union, rather than interaction between

national regulators. It was indeed felt that European Codes of Conduct, drafted by the professional bodies would enable the pooling of expertise and specialised local knowledge on the minimum professional standards and would ensure quality across the Union. The pan-European codes of conduct could thus operate as a targeted trust-building tool accommodating the polyarchy of the regulation of the professions, where there is a multitude of national professional bodies involved. This approach has the dual effect of building more consumer trust on the quality of the services provided by professionals established elsewhere in the Union and of facilitating the interoperability of different regulatory environments.

One could contrast the regulation of the professions with another sector of the economy, where there is intensive quality regulation, but with less regulatory actors involved in this process. In public procurement markets, regulation aims to attain greater allocative efficiency, while ensuring greater quality of services and the performance of universal service obligations. Contrary to the delegated self-regulation of the professions, the regulation of procurement markets emanates directly from the State (it is not delegated to private bodies) and is horizontal in nature, as it applies to all sectors. It is also of relatively limited scope, as the standards imposed aim to preserve the transparency of the tender process and competition in the award of the contracts rather than specific and variable quality norms for each profession, as it is the case for the regulation of professions. The EU Directives that proceeded to the harmonization of the regulatory framework in this sector²⁰² offer thus an important discretion to Member States in regulating the award process and in ensuring the provision of services of general interest. The choice of the instrument of the directive is justified by the relatively low knowledge and sector-specific expertise requirements for the regulation of public procurement and the rather straightforward implementation process, compared to the difficulties that would have incurred the monitoring of the regulation of the professions at the European level, without the assistance of professional bodies and associations.

²⁰² Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors [2004] OJ L 134/1; Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts [2004] OJ L 134/114.

3. Balancing common standards and regulatory diversity by delegating to regulatory networks and agencies: the examples of energy and telecom regulation

In other economic sectors, the pervasiveness and technicality of the regulation and subsequently the high intensity of expert knowledge required mandates the involvement in the EU harmonization process of national regulators. The process of developing interoperable standards across the Union requires their involvement. The aim is to share knowledge and to negotiate the development of common standards. The process is close to that of standard setting organizations, with the difference that in this case the participants to the standard setting are all stakeholders: Member States (national ministries and authorities, the Commission), business and industry representatives, consumer associations, not just the economic operators and that their cooperation takes place or continues after the common standards have been established.

The development of EU harmonization in the regulation of utilities markets may provide a useful illustration of this cooperative partnership between Member States and between the Member States and the Union. For example, the Florence and the Madrid processes on the liberalization of the electricity and gas sectors in 1998 were thought as completing the implementation of the first liberalization directives of 1996, in view of the considerable opposition between the different Member States as to the degree of the opening of the sectors to competition and the dismantling of national monopolies²⁰³. When the early EU steps towards liberalisation were taken, utilities markets presented a heterogeneous configuration characterised by State ownership, vertical integration and monopoly. The Florence Electricity Regulatory Forum and the Madrid Gas Regulatory forum provided the platforms for informal discussions and exchange of ideas between the different stakeholders in order to ensure that the important differences that still separated the various domestic approaches could not

²⁰³ P. D. Cameron, 'Creating an Internal Market in Energy: How Can the tools be more effective?,' Robert Schuman Centre, Policy Papers, 05/01, available at http://www.dundee.ac.uk/cepmlp/staff/pcameron_publications_RSCAS_policy_paper.pdf One could also add the Citizen's Energy forum, established in 2008 as a new regulatory platform based on the experience gained in the Florence and Madrid Forums. See, http://ec.europa.eu/energy/gas_electricity/forum_citizen_energy_en.htm

curtail the achievement of the EU Internal Market in this sector²⁰⁴. This objective was largely achieved. The involvement of the stakeholders through this informal mechanism was an essential trust-building tool that eventually led to the development of more “integrated” European standards, soon after the publication of the second liberalization package in 2003.

Cameron explains that the strategic considerations of security of energy supply or access to fossil fuels have traditionally weakened the force of arguments for energy market integration in the EU, in particular for Member States that rely on imports of energy and gas, and may explain the “strong influence of public service considerations in the electricity and to a lesser extent the gas industry of the EU” that blocked the negotiations for a long time, in comparison to other regulated industries, such as telecoms²⁰⁵. In telecoms the Commission made use of the special powers given by Article 106(3) TFEU, which allows the issuance of directives without requiring extensive negotiations with the Council and the European Parliament. However, in other sectors – especially energy and post – the use of a similar strategy would have clashed with the pronounced political resistance of some Member States. The Florence and Madrid *fora* can thus be explained by the need of the specific sector for an extensive and continuous trust-building process between the different stakeholders, something that was not considered that important in the development of the EU framework in the telecom sector.

More importantly, the cooperation between Member States and between the member States and the Commission continued even after the emergence of harmonized standards in these sectors. This is, in part, due to the specificities of the regulatory arrangements in the utilities sector. Electricity and telecoms have been traditionally regulated through public ownership or directly by government departments, less so by independent administrative authorities. Generally, with the main exception of the UK, there were initially no independent regulators in most of the EU Member States.²⁰⁶ Central governments were the exclusive rule-setters and

²⁰⁴ Ibid., p. 5.

²⁰⁵ Ibid.

²⁰⁶ In contrast with the US, for most part of the twentieth century there were very few NRAs in European countries. The situation was only altered when Britain began to create new agencies along with the privatisation process occurred during the 1980s. Note, however, that similar semi-independent bodies (‘regulatory commissions’) had already been developed in the UK during the 19th century (see C. D. Foster, *Privatization, Public Ownership and the Regulation of Natural Monopoly* (Basil Blackwell: Oxford, 1992) ch. 2).

concentrated most of the regulatory powers. The choice of a government department to regulate often signalled that the objectives pursued by the State expanded beyond the usual focus of curbing the effects of market power and reducing negative externalities. A number of social or protectionist aims were also framing regulatory strategies.

The absence of a clear mandate with specific objectives and priorities for each national regulator, in conjunction with the strategic dimension of these sectors made the development of regulatory interoperability and a level playing field between the different Member States an unachievable dream. Expanding the scope of the market and constraining national regulations with the implementation of EU competition rules would have been a possible option if the overall aim of the EU legislator was to dismantle the various national regulatory barriers to an Internal market for electricity. The establishment of a European federal regulator could have been another. None of these options was nevertheless chosen. Instead, the European legislator imposed the establishment, in each Member State, of independent national regulatory authorities (NRAs)²⁰⁷, which contribute to “the development of the internal market and of a level playing field by cooperating with each other and with the Commission in a transparent manner”²⁰⁸. The NRAs were also integrated in a European network of regulators, called “ERG” in telecoms and “ERGEG” in energy²⁰⁹, both founded in order to promote cooperation between regulators, to draft guidelines and policy proposals and, more generally, to promote cognitive convergence at the EU level²¹⁰.

²⁰⁷ See, for instance, Article 23(1) of Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC [2003] L 176/37, noting that ‘Member States shall designate one or more competent bodies with the function of regulatory authorities. These authorities shall be wholly independent from the interests of the electricity industry. They shall, through the application of this Article, at least be responsible for ensuring non-discrimination, effective competition and the efficient functioning of the market’ Art. 25 of Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC [2003] OJ L 176/57.

²⁰⁸ Art. 23(12) of Directive 2003/54/EC, above.

²⁰⁹ In the field of electronic communications, the Commission established the ‘European Regulators Group’ (ERG) in 2002. See, Decision establishing the European Regulators Group for Electronic Communications Networks and Services [2002] OJ L 200/38 (as amended by Decision 2004/3445 [2004] OJ L 293/20). In the energy sector, the ‘European Regulators’ Group for Electricity and Gas’ (ERGEG) was established in 2003 as the Commission’s formal advisory group of energy regulators. See, Decision establishing the European Regulators Group for Electricity and Gas [2003] L 296/34. The Council of European Energy Regulators (CEER), a non-profit association of European electricity regulators operates as a preparatory body for the ERGEG.

²¹⁰ For instance, see, the Guidelines of Good Practice developed by the CEER and the ERGEG <http://www.energy->

It is possible to conceive the involvement of independent administrative regulators as a credible commitment tool²¹¹ by the Member states that they will not adopt protectionist strategies in the future and that only regulatory measures that expert bodies such as national regulators judge as necessary for the normal operation of the industry (and justified by a market failure, externality or identifiable need to provide public services) will be adopted. Because of the nature of the European legislative process, Member States still enjoy, however, a high degree of regulatory autonomy. The directives merely set up a general framework that must be ‘transposed’ to the internal legislation of Member States. Whilst generally most – if not all – NRAs have broad duties and extensive powers to oversee their respective markets, their strategies and behaviour heavily diverge²¹². Their degrees of discretion are different; their objectives and priorities vary²¹³, the scope of their jurisdiction is dissimilar (e.g. some have concurrent jurisdiction with antitrust authorities), and finally, their procedures to set tariffs are also very disparate.²¹⁴ Certainly, the European Commission, as the main governmental principal, casts a “double shadow of hierarchy” over the sectoral governance agents (NRAs and the network of NRAs). This is achieved through the threat of further legislation and of enforcing EU competition law²¹⁵, both options been employed effectively by the Commission²¹⁶.

regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Guidelines%20of%20Good%20Practice/Cross-Sectoral See also, ERG(03)30 - Common Position on the Approach to Appropriate Remedies in the new regulatory framework ERG (03) 30rev1.

²¹¹ M. Thatcher, ‘Delegation to Independent Regulatory Agencies: Pressures, Functions and Contextual Mediation’, *West European Politics* 25 (2002) 125-147, p. 133; G. Majone, ‘Two Logics of Delegation: Agency and Fiduciary Relations in EU Governance’, *European Union Politics* 2 (2001) 103-122; G. Majone, ‘The Regulatory State and Its Legitimacy Problems’, *West European Politics* vol. Issue 22 (1999), 1-24, p. 4; G. Majone, ‘The Politics of Regulation and European Regulatory Institutions’, in: J. Hayward and A. Menon, (eds.) *Governing Europe* (Oxford University Press, 2003), ch. 17.

²¹² See, for instance, M. Thatcher, ‘Regulatory Agencies, the State and Markets: a Franco-British Comparison’, *J. Eur. Pol.* 14(7) (2007), 1028-1047 (noting the similar formal structures but the different strategies of NRAs in France and Britain).

²¹³ Objectives such as climate change and security of supply have been added to the long-standing aim of introducing competition for the benefit of consumers.

²¹⁴ The most recent directives significantly enhance the independence of NRAs in Member States. See, Directive 2009/72/EC, OJ [2009] L 211/55, concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, chapter IX (articles 35 – 40).

²¹⁵ B. Eberlein, ‘The Making of the European Energy Market: The Interplay of Governance and Government’, *Journal of Public Policy* vol 28 issue 1 (2008), 73-92.

²¹⁶ See, the energy sector enquiry in 2005, followed by a number of high profile cases of competition law enforcement in the electricity and gas sector (in mergers, state aids and antitrust) and finally the recent third liberalization package adopted in 2009.

The recent third liberalization package in energy moved towards a more centralised governance structure²¹⁷. This resulted in the creation of a formal agency in the energy sector, the ‘Agency for the Cooperation of Energy Regulators’ (ACER)²¹⁸, in charge of regulatory cross border issues and coordination of the work of NRAs. Likewise, the Commission launched a review of the current regulatory rules in the telecommunications sector in November 2007.²¹⁹ The proposals for reform included the establishment of a European agency (the ‘Electronic Communications Market Authority’, ECMA) with powers to act centrally and coordinate actions of NRAs. The new package for electronic communications did not establish a strong central authority but introduced instead the Body of European Regulators for Electronic Communications (BEREC), which replaced the ERG as an exclusive forum of cooperation among NRAs and between NRAs and the Commission. The Office, a Community body with legal personality, would support BEREC and would have legal, administrative and financial autonomy. BEREC is more integrated to the EU legal framework than the ERG but it is also a less centralised governance tool than the initial Commission’s proposal on the establishment of a European agency in the telecom sector²²⁰.

While the European agency in the energy sector emanated from proposals of the national regulatory authorities within the context of the ERG recognizing the value of voluntary cooperation between national regulatory authorities within a EU structure with clear competences and with the power to adopt individual regulatory decisions in a number of specific cases²²¹, in the area of electronic communications, the BEREC

²¹⁷ Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003 [2009] OJ L 211/15; Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005 [2009] OJ L 211/36; Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC [2009] OJ L 211/55; Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC [2009] OJ L 211/94.

²¹⁸ Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators [2009] OJ L 211/1;

²¹⁹ See, Amended proposal for a Regulation of the European Parliament and of the Council establishing the European Electronic Communications Market Authority (EECMA) - COM(2008) 720 — 2007/0249 (COD).

²²⁰ Regulation (EC) No 1211/2009 of the European Parliament and of the Council of 25 November 2009 establishing the Body of European Regulators for Electronic Communications (BEREC) and the Office [2009] L 337/1.

²²¹ Recital 3 of Regulation (EC) No 713/2009, above..

does not have any power to adopt individual regulatory decisions and is a much less integrated institution within the EU framework than ACER. Its aim is to contribute to a consistent regulatory practice by facilitating cooperation among NRAs, and between NRAs and the Commission. The BEREC does not duplicate the work of NRAs, but only aims to develop greater policy consistency among NRAs by helping them to exchange information and knowledge on their practical experiences and by intensifying cooperation and coordination. As it is clearly explained in Regulation 1211/2009, “(t)he EU regulatory framework sets out objectives to be achieved and provides a framework for action by national regulatory authorities (NRAs), whilst granting them flexibility in certain areas to apply the rules in the light of national conditions”²²².

The different degree of integration to the Community structure of the European regulation of telecoms and energy may be explained by the varying levels of trust between national regulatory authorities in these two areas. The latter may be due to the variety of concerns addressed by energy regulation in comparison to the regulation of telecoms. Environmental concerns, security of supply and public service obligations are vague enough and provide more space for opportunistic behavior by NRAs in order to promote protectionist interests than the comparatively fewer public interest objectives and principles that are integrated in the Union’s legal framework for electronic communications. Because of the variety of objectives pursued and the possible occurrence of opportunistic behavior, one could reasonably assume that there was a lower level of trust between NRAs in the energy sector, in comparison to the telecom sector, which justifies the different patterns of evolution of institutional arrangements in these sectors, although, in both cases, the starting point was similar (loose networks of NRAs). It was felt that there need to limit the discretion of NRAs in the energy sector and that a regime more integrated to the EU institutional structure, could have led to fewer instances of opportunistic behavior. In the electronic communications sector, the regulatory framework did not promote pluralistic concerns but was mainly targeted to practices extending or reinforcing market power. This characteristic of the regulatory framework reduced the risk of opportunistic behavior by NRAs and enabled cooperation between them, without the need to have recourse to a more centralized institutional framework. In conclusion, the higher level

²²² Recital 3 of Regulation (EC) No 1211/2009, above.

of institutional distrust between NRAs in the energy sector required the establishment of different institutions than in the telecommunications sector.

4. The evolution of regulatory networks to more solidified and centralized regulatory authorities: the example of financial services

In the financial services sector, the Lamfalussy process²²³, introduced in 2002 in securities regulation and in 2003 in banking and insurance, led to the development of a regulatory framework for the financial system in Europe, by integrating national regulatory authorities (NRAs) in the definition and operation of the newly adopted common standards. This approach based on the cooperation of NRAs followed the failure of the Single European Act to establish a European financial market, because of the difficulties faced in applying the principle of mutual recognition to banking, insurance and investment services²²⁴.

In the 1960s and 1970s, the financial systems of EU Member States were largely incompatible to each other²²⁵, in view of the different monetary systems, their loose cooperation in the monetary policy area, as well as the failure of integrating the freedom of cross-frontier provision of financial services in the Community *acquis*, notwithstanding the significant steps taken with regard to the right of establishment of foreign banks with the adoption of the first banking directive in 1977²²⁶. These first attempts of Community harmonization contained a major innovation in so far as they institutionalized cooperation procedures through the creation of Committees composed of senior civil servants from the Member States as well as from the European Commission, thus associating both the Commission and the Member

²²³ Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, February 2001, available at http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf

²²⁴ E. Posner, 'The Lamfalussy Process: Polyarchic Origins of Networked Financial Rulemaking in the EU', in: C. F. Sabel and J. Zeitlin (eds.) *Experimentalist Governance in the European Union: Towards a New Architecture* (OUP, 2010), 43, p. 46.

²²⁵ J. Story and I. Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems* (MIT Press: Cambridge, 1997).

²²⁶ First Council Directive 77/780/EEC of 12 December 1977 on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions [1977] L 322/30.

States in the initiation of legislation in this area²²⁷. This cooperation expanded with the development of the European Monetary System in 1979.

The principle of equivalence with its deregulatory potential formed the cornerstone of the development of the European framework in this area. The Single European Act's strategy in the financial services sector was based on the belief that liberalization, in the sense of restricting regulatory barriers to trade, was a prerequisite to progress in the Internal Market²²⁸. This required a coordinated effort to achieve in view of the important proliferation of state and non-state like actors in the political game: umbrella organizations representing banks, insurance companies, consumer associations, at both EU and international levels, such as the International Federation of Stock Exchanges, the International Organization of Securities Commissions, the Basel Committee on banking Supervision, international organizations involved in this area, such as the OECD, UNCTAD, the GATT and major players in the global financial industry, such as the US and Japan. The aim of market integration had also to accommodate additional concerns than trade gains, such as financial stability, the need for prudential regulation, the preservation of the global competitiveness of the European financial industry sector, the linkage of the financial services sector with monetary and more broadly economic policy.

As it is illustrated by the choice of the instrument of harmonization by community directives, the simple operation of the equivalence principle through a case by case enforcement of the negative integration rules would have been inadequate, precisely because of the plurality of public interests to take into account and actors to involve. However, as Jonathan Story and Ingo Walter noted in their seminal study of financial integration in Europe,

“(f)inancial services proved the least amenable to legislative activism. Trust between Europe’s financial centres was a scarce commodity. Competition prevailed over cooperation. Tax regimes differed. Ideas diverged about the role of capital markets.²²⁹”

The result of the opposition between these divergent forces led to a stalemate for more than a decade, before the Council of the Union proposed the Financial

²²⁷ J. Story and I. Walter, *Political Economy of Financial Integration in Europe: The Battle of the Systems*, above, p. 15.

²²⁸ *Ibid.*, p. 17.

²²⁹ *Ibid.*, p. 25.

Services Action Plan (FSAP), which was finally adopted in March 2000. The FSAP included a number of legislative measures, defined across strategic objectives, with the objective to advance convergence between the different financial systems of the Member States, in view, in particular, of the monetary union and the constitution of a single currency²³⁰. The bulk of the work for the FSAP was done by a Financial Services Policy Group, composed by personal representatives of the ECOFIN ministers, the European Central Bank, and put under the chairmanship of the Commission. Establish linkages between national bureaucracies and the European Institutions active in the reform of the financial sector was an important part of this strategy. As it was acknowledged in the FSAP,

“(a)t present, decisions on appropriate supervisory arrangements are determined at national level, and the supervision of the banking, insurance and securities sectors is predominantly conducted at that level. Member States have developed different models for performing these tasks. Mutual confidence in the effectiveness of partner country financial supervision and regulation – whether that be undertaken by a consolidated authority for the entire sector or by separate sectoral authorities that co-operate and co-ordinate effectively – is the key ingredient for successful cross-border supervision”²³¹.

An important ingredient of this new governance structure was the involvement of key stakeholders in order to promote “a more inclusive and consensual approach in shaping policy from an early stage and in advance of drafting legislation”, including not only the EU institutions or representatives of national regulators, but also market practitioners and consumers²³². This constituted a major evolution from the framework existing at the time for cross-border cooperation, which consisted of bilateral Memoranda of understanding between national supervisors. The collaboration with international private *fora*, such as the Basel Committee, or the constitution of new “high level” European *fora* representing stakeholders and integrating them in the process of forging consensus, “without prejudice to the

²³⁰ COM(1999)232, available at http://ec.europa.eu/internal_market/finances/docs/actionplan/index/action_en.pdf

²³¹ Ibid., p. 14. Emphasis added.

²³² Ibid., p. 16.

Commission's legal right of initiative"²³³, formed part of this new strategy. The creation by the Council of Economic and Finance Ministers in July 2000 of a Committee of Wise Men on the Regulation of European Securities Markets, under the chairmanship of Alexandre Lamfalussy, can also be explained by the need to combine expertise in a quickly evolving sector with the benefits of a "committee of independent persons"²³⁴ that would include in the process national regulators and the various groups and interests affected by the emerging regulatory framework.

Concretely, the Lamfalussy report initiated a new mechanism to promote convergence in the European financial supervisory practice, based on four levels²³⁵. At Level 1, the Commission can initiate a formal proposal setting broad framework principles which can be adopted by the Council and the Parliament by means of Directive/Regulation, after a full consultation process under the normal EU legislative procedure. At the second level, new committees have been established: a European Securities Committee (ESC) in the area of securities and the European Banking Committee in the banking sector, with the mission to assist the European Commission in determining how to implement the details of the Level 1 framework. These Committees composed of high level Member State representatives are chaired by the Commission. Their role in the process is central.

The Lamfalussy process thus recognized two layers in the legislation related to financial markets: basic political choices translated into broad but sufficiently precise framework norms (Level 1) and more detailed technical measures, in full conformity with this framework, which implement the objectives pursued by the legislation (Level 2). The ESC and other Level 2 committees have been vested with enough comitology powers to revise and update EU legislation, in addition to their advisory function. At Level 3, lay committees composed by national regulators: the Committee of European Banking Supervisors (CEBS) or the Committee of European Securities Regulators (CESR), which work on joint interpretation, recommendations, consistent

²³³ Ibid.

²³⁴ Initial Report of the Committee of Wise Men on the Regulation of European Securities Markets, November 2000, available at http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/initial-report-wise-men_en.pdf, at 30.

²³⁵ Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, 15 February 2001, available at http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf, at 19.

guidelines and common standards (in areas not covered by EU legislation) through a peer review process, and a comparison of regulatory practices across the Union to ensure consistent implementation and application. These Level 3 committees ensure a more effective cooperation between national supervisors and a convergence of regulatory and supervisory practices. At Level 4, the Commission can monitor the process by checking compliance in Member States and eventually taking legal action against member States suspected of breach of the EU framework.

This process may be presented as a classic example of negotiation in the shadow of hierarchy²³⁶, where hierarchy is defined as any legislative and executive decisions “that steer democratic governmental action at the national and European level”²³⁷. The process involves the Member States as long as they cooperate in the design and implementation of the common standards. In the absence of a cooperation strategy from their part, the Commission may still intervene. A “double delegation of powers and functions” thus characterizes the governance arrangements in the financial services sector: this is exercised either “upwards” from the national independent regulators to the Commission or “downwards” from the European Commission to regulatory networks²³⁸. Coen and Thatcher conclude that European Regulatory networks, such as the CESR, lack powers and resources, and they exercise mainly an advisory (and secondary) role: for example, the CESR can shape policy “in so far as it can influence the Commission”²³⁹.

Yet, other accounts of the operation of the Level 3 committees in the context of the Lamfalussy process report that the absence of a political consensus between the main principals (the European Parliament and the Council) in the creation of the Markets and Financial Instruments Directive (MIFID) at level 1 left important political decisions to be taken by the CESR (acting as an agent) at levels 2 and 3²⁴⁰. That led to an expansion of the CESR’s role and its transformation to a “central agenda setter”

²³⁶ T. Börzel, ‘European Governnace: Negotiation and Competition in the Shadow of Hierarchy’, *JCMS* vol. 48 issue 2 (2010), 191-209, 200-204.

²³⁷ A. Heritier and D. Lehmkuhl, ‘The Shadow of Hierarchy and New Modes of Governance’, *Journal of Public Policy* vol. 28 issue 1 (2008), 1, at 2.

²³⁸ D. Coen and M. Thatcher, ‘Network Governance and Multi-level Delegation: European Networks of Regulatory Agencies’, *Journal of Public Policy*, vol. 28 issue 1 (2008), 49-71.

²³⁹ *Ibid.*, at 64.

²⁴⁰ E. Posner, ‘The Lamfalussy Process: Polyarchic Origins of Networked Financial Rulemaking in the EU’, in: C. F. Sabel and J. Zeitlin (eds.) *Experimentalist Governance in the European Union: Towards a New Architecture* (OUP, 2010), p. 43.

in the process²⁴¹. The conceptualization of the CESR as operating in the shadow of hierarchy does not also consider that the European Commission's (the intermediary principal) initial proposals for introducing comitology in the financial sectors did not include the establishment of level 3 committees, such as CESR, but only a level 2 committee, the ESC. According to Posner, the development of an "autonomous role" for the CESR, beyond its original mandate, was not expected by some of the principals in the process (the European Parliament and the Commission) and can be explained by a number of attributes: its members' expertise in a highly technical sector, the open consultation processes that enhanced its reputation as an expert technical body in touch with the fast-changing market developments, the "internal capacity-building processes" that included coordination through peer review or transparent benchmarking, the ongoing deliberation process and the existence of conflict-resolution mechanisms²⁴². The conceptualization of regulatory networks as operating under the shadow of hierarchy provides thus a partial explanation of their operation and objectives. It is submitted that, besides the technical expertise, which could have been acquired through different means than the constitution of networks of NRAs, the Lamfalussy approach is intrinsically participatory, consensus-driven and based on open consultation with the aim to promote convergence and build "mutual trust to ensure better implementation" of the EU framework²⁴³, through mediation, delegation of tasks, information sharing. One could also note their contribution to the development of a "common supervisory culture" through staff exchanges and training programmes²⁴⁴.

Furthermore, the theory of negotiation under the shadow of hierarchy does not provide the adequate theoretical framework to explain the replacement of the level 3 committees with a more integrated and centralized institutional structure at the EU level, following the de Larosière report²⁴⁵. The theory fails to explain why the evolution towards a more centralized structure was required, in so far as the "shadow of hierarchy" could already constrain the freedom to act of national supervisors. It is

²⁴¹ Ibid.

²⁴² Ibid.

²⁴³ Communication from the Commission, Review of the Lamfalussy process – Strengthening supervisory convergence, COM(2007) 727 final, p. 9.

²⁴⁴ Ibid., p. 7.

²⁴⁵ The High-Level Group on Financial Supervision in the EU, Report, 25 February 2009, available at http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf.

submitted that the high levels of distrust between national supervisors, because of a higher likelihood of opportunistic behavior in a period of economic and financial crisis and the consequent development of a more intensive competition between Member States increased the costs of cooperation between them under the current framework²⁴⁶.

We provide some context on the reform before moving to implications for our discussion on governance mechanisms. The Commission has recently made proposals for a reform of the institutional structure of the EU supervisory architecture and the constitution of a European System of Financial Supervisors. The proposals establish a new body, the European Systemic Risk Board (ESRB) with the aim to ensure macro-prudential and macro-economic risks regulation and three European Supervisory Authorities (ESA), the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA), which will replace the existing Lamfalussy level 3 committees.

The ESAs are Community bodies with legal personality; they have increased responsibilities to adopt technical standards by qualified majority voting, as well as a general power to ensure the consistent application of EU law. A more formal dispute settlement mechanism enables the ESAs to settle disagreements between national supervisory authorities, by adopting a binding decision. The new institutional arrangement is also justified by the development of a single rule book in order to ensure a “uniform application of rules in the EU”, the main task of the ESAs being to monitor the implementation of the rules by the national supervisors²⁴⁷. In contrast to the Lamfalussy committees, the ESA may take decisions requiring a national supervisory authority to take a specific action or to refrain from an action. In the event the national supervisory authority does not comply, the ESA may act as a last resort and adopt a decision directly applicable to the specific financial institutions.

These increased responsibilities for the ESAs, in comparison to level 3 Lamfalussy committees, the “comply or explain” approach followed with regard to national supervisors and better funding may lead inevitably to the emergence of a more

²⁴⁶ Communication for the Spring European Council, Driving European recovery, COM(2009) 114 final, at 6 noting ‘the existing gaps in preventing, managing and resolving crises and the difficulties caused by a lack of cooperation, coordination, consistency and trust between national supervisors’).

²⁴⁷ Proposal for a Regulation of the European Parliament and of the Council establishing a European Banking Authority, COM(2009) 501 final, p. 3.

centralized system at the EU level. However, they still confer an important role to national supervisors, because of their local knowledge and their close relation to day-to-day operation of companies. The Commission does not exclude a further centralization of the European system of financial supervision after the next review to be completed in three years, if this proves necessary²⁴⁸.

The internal organization of the ESAs and the ESRC, illustrate also the evolution towards a more centralized model. The board of supervisors is certainly the main decision making body of the ESAs. It includes as its voting members the heads of the relevant national supervisory authorities in each Member State. At the same time, the management board that prepares the ESAs work program and adopts the rules of procedure includes a representative from the Commission and four elected members of the Board of supervisors who “shall act independently and objectively in the Community interest”²⁴⁹. A full-time independent chair of the ESA will be responsible for preparing the work and chairing the meetings of the Board of Supervisors and the Management Board, a noticeable change from the loose internal structure of the level 3 Lamfalussy committees. The ESRB does not have a legal personality but is a new European body, whose strength lies in the composition of its General Board, comprising of governors of national central banks, the president and vice-president of the European Central Bank (ECB), a member of the European Commission and the chairpersons of the ESAs. The Chair of the General Board is elected for a period of 5 years and its activity is supported by the secretariat of the ECB. Although the ESRB cannot adopt binding decisions, it is anticipated that it will have an important moral authority because of its high level composition²⁵⁰. It is apparent that these changes mark an evolution towards a more centralized governance mechanism.

5. Open Method of Coordination

The open method of coordination constitutes an additional route for coordination and constitution of a common regulatory culture. The method was first

²⁴⁸ Communication for the Spring European Council, Driving European recovery, above, p. 6.

²⁴⁹ Proposal for a Regulation of the European Parliament and of the Council establishing a European Banking Authority, above, p. 9.

²⁵⁰ Proposal for a Regulation of the European Parliament and of the Council on Community macro prudential oversight of the financial system and establishing a European Systemic Risk Board, COM(2009) 499 final.

relied on for the coordination of employment policies at the Lisbon European socio-economic summit in 2000 and later extended to a variety of policy areas, mainly in the areas of economic policy and employment strategy²⁵¹, where it was conceived of as a tool for the progressive Europeanization of domestic social policy²⁵². The OMC has also expanded to a number of areas beyond social and economic governance (including fiscal policy), such as immigration and asylum, occupational health and safety, innovation policy, environmental protection. The exact content of this method varies considerably, depending on the characteristics of the policy field or the cross-sectoral, sectoral or sub-sectoral character of the reform but the main ingredients of the OMC have been defined by the Lisbon European Council's conclusions in 2000, according to which the OMC is a:

“[...] means of spreading best practice and achieving greater convergence towards the main EU goals. This method, which is designed to help Member States to progressively develop their own policies, involves:

- fixing guidelines for the Union combined with specific timetables for achieving the goals which they set in the short, medium and long terms;
- establishing, where appropriate, quantitative and qualitative indicators and benchmarks against the best in the world and tailored to the needs of different Member States and sectors as a means of comparing best practice;
- translating these European guidelines into national and regional policies by setting specific targets and adopting measures, taking into account national and regional differences;
- periodic monitoring, evaluation and peer review organised as mutual learning processes.

²⁵¹ L. Tholoniati, 'The Career of the Open Method of Coordination: lessons from a "soft" EU instrument', *West European Politics*, vol. 33 issue 1 (2010), 93-117; J. Zeitlin and M. Heidenreich (eds.), *Changing European Employment and Welfare Regimes: the influence of the Open method of Coordination on national reforms* (Routledge, 2009); V. Hatzopoulos, 'Why the open method of coordination is bad for you : a letter to the EU', *ELJ*, vol. 13 issue 3 (2007), 309-342; W. Kerber and M. Eckardt, 'Policy learning in Europe: the open method of co-ordination and laboratory federalism', *JEPP*, vol. 14 issue 2 (2007), 227-247; D. Ashiagbor, *The European employment strategy : labour market regulation and new governance* (OUP, 2005); C. Radaelli, 'The open method of coordination: A new governance architecture for the European Union?' Report for the Swedish Institute for European Policy Studies, Stockholm, (April 2003.)

²⁵² See, K. A. Armstrong, *Governing social inclusion: Europeanization through policy coordination* (OUP, 2010).

[...] A fully decentralised approach will be applied in line with the principle of subsidiarity in which the Union, the Member States, the regional and local levels, as well as the social partners and civil society, will be actively involved, using variable forms of partnership. A method of benchmarking best practices on managing change will be devised by the European Commission networking with different providers and users, namely the social partners, companies and NGOs [...]"²⁵³.

There are considerable differences in OMC modalities and procedures: the well established and historic OMCs, such as the Broad Economic Policy Guidelines (BEPGs) and the European Employment Strategy (EES) involve EU institutions, the Parliament and the Council, which can issue joint recommendations to Member States for the implementation of the detailed BEPGs and EES. In other cases, common European benchmarks and statistical indicators have been devised in order to facilitate cooperation and coordination between the different Member States. In the social sphere, the Member States are also required to prepare National Action Plans, National Strategy Reports or National Progress Reports, which are subjected to the peer review and mutual surveillance of the representatives of other Member States in sectoral Committees, such as the Employment Committee, the Social Protection Committee or the Economic Policy Committee. A common characteristic of all OMC procedures is the non reliance on binding legislation, but instead to “voluntary” compliance and incentives, the co-ordination rather than harmonization of national policies, and the participation of a number of stakeholders and actors beyond Member States. The OMC fulfills thus a different aim than the traditional harmonization or market liberalization approach. According to Sabel and Zeitlin, “the OMC was envisaged by its architects as a “third way” for EU governance between regulatory harmonization and fragmentation, capable of reconciling the pursuit of common European objectives with respect for national diversity while encouraging mutual emulation and experimental learning through comparison of different approaches to shared problems”²⁵⁴.

²⁵³ Presidency Conclusions - Lisbon European Council, 23 and 24 March 2000, available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/00100-r1.en0.htm

²⁵⁴ C. F. Sabel and J. Zeitlin, *Learning from Difference: The New Architecture of Experimentalist Governance in the European Union*, Eurogov, No. C-07-02.

6. The “new approach” to harmonization: taming regulatory diversity

Managing, rather than suppressing diversity becomes an important concern in the regulation of intra-EU trade. Instead of adopting a detailed harmonization of national rules or excluding their application through the joint operation of the principle of equivalence and the market access rule, the European Commission has initiated since the late 1970s a “New approach” to harmonization, which proceeds in defining only the relevant essential requirements that goods have to meet when they are marketed, and delegates the task for the development of these standards to specific standard setting bodies²⁵⁵. This approach is referred to below as “managed harmonization” in order to illustrate its selective, partial and decentralized form in comparison with the classic exhaustive “old” harmonization tool. The “new approach” offers a considerably degree of flexibility to economic operators who are allowed to choose the way they conform to the requirements of the principle of mutual recognition. Member States are also more involved in the process as they can perform controls of the products for both the pre-market (conformity assessment modules) and post-market (market surveillance) stages. The new approach also establishes an early warning system requiring the notification of the adopted measures to the Commission and other Member States and the accreditation of the products by national conformity assessment bodies.

Market surveillance entails an effective cross-border administrative co-operation between Member States. Yet, originally, there was no systematic exchange of information between Member States concerning the criteria and procedures applied at national level for the assessment and surveillance of the bodies put in place, which has encouraged suspicion about uneven levels of implementation. The Commission has then quickly put in place mechanisms to increase the levels of confidence and trust between Member States, for the good operation of the system²⁵⁶. However, it

²⁵⁵ Communication from the Commission of 7 May 2003 to the Council and the European Parliament Enhancing the implementation of the New Approach Directives COM(2003) 240 final.

²⁵⁶ Regulation (EC) No 764/2008 of the European Parliament and of the Council of 9 July 2008 laying down procedures relating to the application of certain national technical rules to products lawfully marketed in another Member State and repealing Decision No 3052/95/EC, [2008] OJ L 218/21; Regulation (EC) No 765/2008 of the European Parliament and of the Council of 9 July 2008 setting out the requirements for accreditation and market surveillance relating to the marketing of products and repealing Regulation (EEC) No 339/93, [2008] OJ L 218/30; Decision No 768/2008/EC of the

also noted that “Community harmonisation legislation shall restrict itself to setting out the essential requirements determining the level of such protection and shall express those requirements in terms of the results to be achieved”²⁵⁷.

7. Managed regulatory mutual recognition: the example of the Services Directive

The principle of regulatory mutual recognition offers an alternative governance mechanism than harmonization and judicial mutual recognition. It provides more flexibility than the “new approach” as it “obviates the need to set EU norms for a particular area or sector altogether – leaving it to Member States to set standards to protect public interest concerns, whilst avoiding that differential standards amount to barriers to trade”²⁵⁸. It also appeals to a different institution than courts, for dispute resolution, by providing mediation between conflicting interests at the regulatory level. Judicial mutual recognition may, however, evolve to regulatory mutual recognition. The free movement of goods offers an illustration of this evolution: following the *Cassis de Dijon* judgment of the ECJ²⁵⁹, the principle of mutual recognition was reframed and codified in legislative texts²⁶⁰.

The Services directive provides an interesting illustration of regulatory mutual recognition²⁶¹. It is well known that the initial draft of the Services Directive attempted to bring a substantial change from the *status quo*²⁶². The principle of the country of origin, included in the initial version of the proposal, subjected the provision of services (authorization, exercise, consumer protection) entirely to the rule and

European Parliament and of the Council of 9 July 2008 on a common framework for the marketing of products, and repealing Council Decision 93/465/EEC [2008] OJ L218/82.

²⁵⁷ Art. 3(1), Decision No 768/2008/EC, *ibid*.

²⁵⁸ Commission Staff Working Paper, Instruments for a modernised single market policy, COM(2007) 724 final, at 10.

²⁵⁹ Case 120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein* [1979] ECR 649.

²⁶⁰ Regulation (EC) No. 764/2008 laying down procedures relating to the application of certain national technical rules to products lawfully marketed in another Member State and repealing Decision No 3052/95/EC [2008] OJ L 218/21.

²⁶¹ Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on Services in the Internal Market [2006] OJ L 376/36.

²⁶² C. Barnard, ‘Unravelling the Services Directive’ *CMLRev* 45 (2008) 323; G. Davies, ‘Services, citizenship and the country of origin principle’, Mitchell Working Paper series no. 2/2007, (Europa Institute, Edinburgh University;); B. de Witte, ‘Setting the scene: How did services get to Bolkestein and why?’ Mitchell Working Paper series no. 3/2007, (Europa Institute, Edinburgh University;); M. Chang, D. Hanf and J. Pelkmans, ‘The Services Directive: Trojan Horse or White Knight?’ *Journal of European Integration*, vol. 32 (2010), 97-114.

controls of the home Member State, the host state not being able to impose additional requirements nor to monitor their enforcement. The country of origin would have thus led to a complete transfer of regulatory authority from the host state to the home State.

If one adopts the assumption that regulatory systems represent domestic preferences and institutional conditions at the domestic level determining the balance between divergent domestic interests²⁶³, such transfer of authority involves the acceptance that only foreign interests will be represented in the decision-making process. There should be a considerable level of trust between the different systems. A simple similarity of values and regulatory culture would not be sufficient. Nicolaidis and Egan rightly remark that “even high regulatory compatibility does not in itself produce absolute trust, and thus is not matched by full delegation of authority”²⁶⁴. One could, indeed, distinguish between the principle of “pure” mutual recognition from that of “managed mutual recognition”, the latter enabling the host state to impose its own rules concerning the authorization, exercise and quality requirements on a cross-border service provider, of course as long as the principles of equivalence and proportionality are kept in sight. Kalypso Nicolaidis explains:

“(a)s an outcome, managed mutual recognition can be contrasted with ‘pure’ mutual recognition in the same sense as managed trade can be contrasted with absolute free trade. Pure mutual recognition implies the granting of fully unconditional and open-ended rights (of action, access) to private market agents as a product of a free trade contract between states. In contrast, managed mutual recognition introduces conditionality in the contract. The four main dimensions along which mutual recognition can be managed or fine-tuned are: (a) prior conditions for equivalence, from convergence to inter-institutional agreements; (b) varying degrees of automaticity of access (for example, residual host country requirements; (c) scope of activities or features

²⁶³ If one follows the assumptions of liberal intergovernmentalism, see A. Moravcsik, ‘Preferences and power in the European community: A Liberal Intergovernmentalist Approach’, *JCMS*, vol. 31 issue 4 (1993), 473-524, 480-481.

²⁶⁴ K. Nicolaidis and M. Egan, ‘Transnational market governance and regional policy externality: why recognize foreign standards?’, *JEPP*, vol. 8 issue 3, (2001) 454-473, p. 470.

covered by recognition; and (d) ex post guarantees or safeguards, including mutual monitoring and ultimately provisions for reversibility”²⁶⁵.

It is well known that the final version of the Directive did not include the principle of the country of origin, and replaced it with a “freedom to provide services” clause. Article 16 of the Directive requires Member States to abstain from imposing their own requirements on cross-border service providers (but they can still impose them to their own national operators) except where justified by the four reasons enumerated in Article 16(1) and (3): public policy, public security, public health, protection of the environment. The latter offer only a limited, in comparison to the previous case law on imperative requirements of general interest, opportunity to Member State to follow diverse public interest objectives. Furthermore, any such requirements have to comply with the principles of non-discrimination, necessity and proportionality. Article 16(2) lists a number of restrictions, for which there is a “strong presumption” that they cannot be justified by the four public interest objectives referred to previously, “since they will normally be disproportionate”²⁶⁶. However, this falls short of an obligation to refrain from all control.

It is possible to conclude that the scope of managed regulatory mutual recognition, introduced by the Directive, offers less room to regulatory diversity than judicial mutual recognition, as it curtails the discretion of the Member States to justify restrictive measures. Contrary to the Directive, the case law has been always open-ended on the list of reasons of public interest that can justify a restriction to the freedom to provide services. At the same time, the scope of application of the principle of managed regulatory mutual recognition is narrower than that of judicial mutual recognition.

First, a long list of sectors is excluded from the application of the Directive’s principle of “freedom to provide services”²⁶⁷. The Treaty provisions on the freedom to

²⁶⁵ K. Nicolaidis, ‘Kir forever? The Journey of a Political Scientist in the Landscape of Mutual Recognition’, in: M. P. Maduro and L. Azoulai (eds.), *The Past and Future of EU Law* (Hart Pub.:Oxford, 2010), p. 451.

²⁶⁶ European Commission, Handbook on the Implementation of the Services Directive, 2007, available at http://ec.europa.eu/internal_market/services/services-dir/index_en.htm , at 39.

²⁶⁷ European Commission, Handbook on the Implementation of the Services Directive, 2007, above, pp. 10-13. The list is long: non-economic services of general interest, financial services, electronic communication services and networks, services in the field of transport, services of temporary work agencies and social services relating to social housing, childcare, support of families and persons in need, healthcare, audiovisual and radio broadcasting services, gambling activities, activities connected with the exercise of official authority, private security services.

provide services (and the market access rule) may still apply for these sectors and some of these services are already subject to sectoral regulation at the EU level (e.g. financial services, electronic communications and networks).

Secondly, article 1(6) of the Directive pronounces that it does not affect labour law or the social security legislation of the Member States, including all legal or contractual provisions concerning employment conditions, working conditions, health and safety at work and the relationship between employers and workers. The Directive has no impact on fundamental rights and proffers that there is no inherent conflict between the exercise of fundamental rights and the fundamental freedoms of the Treaty; “neither prevails over the other”²⁶⁸.

Thirdly, article 17 of the Directive contains a number of derogations from the principle of “freedom to provide services”: services of general economic interest and intellectual property rights are among the activities covered by these derogations, as well as a number of activities which have already been subjected to EU harmonization measures. Finally, Article 18 allows for derogations from the principle of “freedom to provide services” on a case by case basis for safety reasons. This is done under strict conditions, in particular the requirement for the host Member State to assess whether the measures considered provide a “real added value” over measures adopted by the home State or to require the assistance of the home Member State prior to imposing unilaterally these measures. These numerous exceptions were placed in the Directive with the aim to attenuate the effect of the principle of the country of origin and in order to achieve consensus among Member States for its adoption²⁶⁹. The fact that they have been maintained, even after the abandonment of the country of origin principle, indicates that the Member States have gained some regulatory autonomy in these sectors, as it is improbable that the case law will take an opposite direction and apply the market access rule in an expansive way.

It is significant that the Commission’s communication concerning the consequences of the *Cassis* judgment in the area of the free movement of goods²⁷⁰ emphasized only the Commission’s role in implementing the principle of mutual

²⁶⁸ Ibid., at 15.

²⁶⁹ M. Chang, D. Hanf and J. Pelkmans, ‘The Services Directive: Trojan Horse or White Knight?’, above, p. 99.

²⁷⁰ Communication from the Commission concerning the consequences of the judgment given by the Court of Justice on 20 February 1979 in Case 120/78 (*Cassis de Dijon*), [1980] OJ C 256/2, .

recognition. The Services directive goes much further and contains a number of provisions establishing an administrative cooperation between Member States. The objective is to create an institutional mechanism in order to manage “infrastructural heterogeneity” within Member States which can be a barrier to cross-border cooperation²⁷¹. The Directive first proceeds to an administrative simplification of the procedures and formalities applicable to service providers²⁷². In particular, it requires Member States to set up “points of single contact” as single interlocutors for service providers, thus enabling the collection and exchange of information between them. For example, Member States have to accept documents from other Member States which serve an equivalent purpose and which indicate that the requirement in question has been satisfied. Such measures of simplification as well as the provisions of the Directive on the quality of services increase the confidence of consumers to foreign providers of services. More importantly, the Directive promotes a deep level of administrative cooperation between the Member States, as a prerequisite for the operation of the principle of managed regulatory mutual recognition. The aim is “to enhance both mutual trust between Member States and the confidence of providers and consumers in the Internal market”²⁷³.

Concretely, chapter VI of the Directive sets a system of cooperation based on the obligation of mutual assistance between the competent authorities of Member States²⁷⁴. This obligation is comprehensive and encompasses also the possibility to find and exchange information between the different national authorities. The Internal Market Information (IMI) System, constituted at this respect, offers the technical means to promote communication between Member States²⁷⁵. This networked environment complements existing initiatives in other areas, such as the RAPEX (Rapid alert system for non-food dangerous products), the RASFF (Rapid alert system for food and feed) or the Consumer Protection Cooperation Network. Its aim

²⁷¹ S. Weatherill, ‘Promoting the Consumer Interest in an Integrated Services Market’, *Mitchell Working Paper series* no. 1/2007, (Europa Institute, Edinburgh University,) available at http://www.law.ed.ac.uk/file_download/series/23_promotingtheconsumerinterestinanintegratedservicesmarket.pdf p. 15 (last accessed August 26, 2010).

²⁷² Art. 5-8 of Directive 2006/123/EC.

²⁷³ European Commission, Handbook on the Implementation of the Services Directive, 2007, available at http://ec.europa.eu/internal_market/services/services-dir/index_en.htm , at 7.

²⁷⁴ Art. 28-36 of Directive 2006/123/EC.

²⁷⁵ Commission Decision setting out the practical arrangements for the exchange of information by electronic means between Member States under Chapter VI of Directive 2006/123/EC of the European parliament and of the Council in services in the internal market, [2009] OJ L 262/32.

consists in “the building of mutual trust” and the establishment of a partnership where responsibility is “shared” between the Member States and the Commission²⁷⁶. Articles 30 and 31 of the Directive provide for a clear division of supervisory tasks between the different Member States in cross-border service provision, depending on the nature of the measures and rules envisioned: if these do not fall under the scope of the “freedom to provide services” it is the host Member state which is responsible to supervise the activity of the provider; if the measures fall within the scope of Articles 16 and 17 and are thus prohibited, it is the home Member State that ensures compliance with its own national requirements and guarantees that the service provider has the required authorizations, the host Member State being only able to carry factual checks on its own initiative under specific conditions²⁷⁷. Finally, if the host Member State benefits from a case by case derogation under Article 18, there is a specific procedure for managing these situations of breaking-trust²⁷⁸.

One of the most innovative aspects of the Services Directive is the mutual evaluation process that enables Member States to comment on the reports submitted by other Member States after reviewing their legislation for conformity to the Directive²⁷⁹. The Commission will provide annually analyses and orientations on the application of these provisions in the context of the Directive. The recent Commission’s Communication “Towards a Single Market Act” reiterates the importance of the mutual evaluation mechanism and suggests its extension beyond the Services directive²⁸⁰. This forms part of the broader strategy of the Commission to build a partnership with the Member States in the management of the Internal Market²⁸¹. As it was acknowledged by the Commission in its Recommendation on measures to improve the functioning of the single market,

“(t)he measures taken by the Member States and those taken by the Commission should complement each other. A coordinated and cooperative

²⁷⁶ Commission Recommendation on measures to improve the functioning of the single market, [2009] OJ L 176/17. According to the most recent Communication from the Commission, Towards a Single Market Act, COM(2010) 608 final, at 31, the Commission will extend the application of the IMI to other legislative areas than the Services Directive.

²⁷⁷ These conditions are set by Art. 31(4) of Directive 2006/123/EC, above: the checks inspections or investigations should not be discriminatory, they should not be motivated by the fact that the provider is established in another Member State and they should be proportionate.

²⁷⁸ Art. 35 of Directive 2006/123/EC, above.

²⁷⁹ Art. 39 of Directive 2006/123/EC, above.

²⁸⁰ Communication from the Commission, Towards a Single Market Act, above, p. 31.

²⁸¹ *Ibid.*, p. 32.

approach — in partnership between the Commission and Member States — with a common objective of improved transposition, application and enforcement of single market rules, is vital to ensure the proper functioning of the single market. The partnership approach [...] goes beyond the already established cooperation in a number of single market policy areas. It requires establishing and maintaining closer cooperation within and between the Member States, and with the Commission, in all areas that are relevant for the single market. It also implies that Member States assume shared responsibility for and therefore a more proactive role in managing the single market²⁸².

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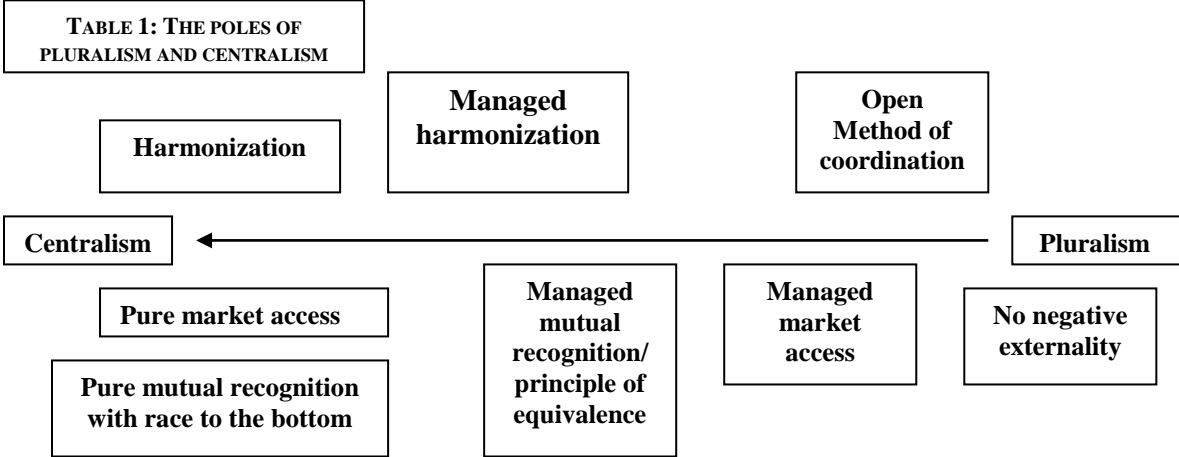
In conclusion, these different case studies illustrate the porosity of the tripartite distinction between the market access/national treatment rule, the principle of equivalence and that of harmonization as discrete governance mechanisms. The emergence of different forms of cooperation in various sectors of trade in services, based on the development of the overarching principle of mutual recognition, as well as the failure of adopting a more horizontal and uniform approach for the regulation of trade in services, following the retreat of the country of origin principle from the final version of the Services directive, illustrate the complex interaction between the centrifugal forces of pluralism and the centripetal tendencies of managing the risks of cooperation. These tensions eventually lead to the emergence of different cooperation *equilibria* in various sectors.

C. Pluralism, trust and distrust

The conclusion that one may draw from the survey of governance tools in the previous sections is that “ideal” governance categories, such as national treatment, market access and harmonization do not correspond to the much more complex reality of regulating inter-state trade in services. Managed market access, managed mutual recognition, managed harmonization, regulation through networks and

²⁸² European Commission, Recommendation on measures to improve the functioning of the single market [2009] L 176/17, recital 5.

agencies, governance by delegation to private parties, open method of coordination and other soft coordination mechanisms compose a much more complex picture of the various governance arrangements in the area of services trade. They also challenge common assumptions on the location of these different governance mechanisms in the *continuum* between the poles of regulatory diversity/regulatory pluralism and centralism/uniformity, which can either refer to the adoption of common regulatory standards (harmonization) or the free interplay of demand and supply in a “Single” market for regulations (pure mutual recognition with race to the bottom) or services (pure market access).



In this mapping exercise (see Table 1), managed harmonization does not lead automatically to centralism and rests between the two poles. The active involvement of national independent regulatory authorities in the negotiation and evolving constitution of harmonized standards, as it has been the case with the Lamfalussy process in the financial services sector or with the NRAs networks in the energy and telecom sectors, ensures that national diversities and regulatory cultures will be taken into account. The continuous involvement of these authorities in the process guarantees that this is not a one-off inclusion but a continuous interaction where experiences are shared and regulatory experimentation is valued. The Open Method of Coordination with its emphasis on dialogue, partnership, peer review and benchmarking seems also to influence the strategy followed by recent attempts of managed harmonization, such as the Services Directive, signaling the progressive abandonment of the strict format of detailed sectoral rules for more open-ended

standards and relying on the continuous cooperation and interaction between national authorities to manage conflicts.

Yet it seems that the European Court of Justice has not taken stock of this evolution and is still treating the market access-national treatment rule/mutual recognition/harmonization trilogy as the holly triad of European Internal market law. For example, in the recent *Ker-optica* case on free movement of goods the Court held that “Article 34 TFEU [the equivalent article for the free movement of goods to Art. 56 TFEU] reflects the obligation to comply with the principles of *non-discrimination* and of *mutual recognition* of products lawfully manufactured and marketed in other Member States, as well as the *principle of ensuring free access of EU products to national markets*”²⁸³. There might be a reason explaining the stickiness of the trilogy in the judicial imagery of the Internal Market project and the failure to capture the managed character of market access, recognition and harmonization.

A possible explanation is that the trilogy may perfectly explain the process of economic integration if the latter’s aim is uni-dimensional: the erosion of barriers to trade with the removal of regulatory impediments and the convergence towards unified regulatory standards. However, in a legal order valuing regulatory pluralism, the outcomes of economic integration cannot be uniform. One should take into account the evolving objectives pursued by the different political and institutional entities that operate within the “directly-deliberative polyarchy” of the European regulatory area²⁸⁴.

In the polyarchic system of European governance, framework goals are jointly established by a multi-level institutional system comprising national ministries or national regulatory authorities, networks of national authorities, EU agencies and EU institutions, private entities (through codes of conduct): this constructs an Internal Market framework within which the lower-level units (national administrations) can protect public health, social solidarity, consumers, the environment in ways that grow out of their own traditions. As Mario Monti noted in his report on “A New Strategy for the Single Market”,

²⁸³ Case 108/09, *Ker-Optika bt* [2 December 2010], para. 48, emphasis added

²⁸⁴ C. F. Sabel and J. Zeitlin, *Learning from Difference: The New Architecture of Experimentalist Governance in the European Union*, Eurogov, No. C-07-02, (May 2007,) p. 9.

“(t)he single market itself is today part of a context, which has dramatically changed. In turn, the actors to be involved in the initiative – Europe's policy makers and stakeholders – are more diverse and present a wider range of preferences and interests”²⁸⁵..

The plurality of objectives and interests, “economic” and “social”, embedded in the project of the Internal Market, cannot be brought to fruition within the simple framework of the market access/equivalence/harmonization trilogy that has long served as the mantra of the economic integration project. As we have previously shown these principles are not the only conceivable conceptual categories of governance in the Internal Market: there is a multitude of other tools and possible combinations that can achieve stochastic equilibrium in a pluralistic setting. Some institutional arrangements may therefore work in some areas but not in others. The regulation of trade in services constitutes a telling example of this plurality of objectives and consequently institutional arrangements that break with the traditional categories and highlight a different, theoretically richer, conception of economic integration than the joint aims of regulatory sameness and the erosion of barriers to trade.

Nevertheless, this evolution contrasts with ambivalent rhetoric employed by the Commission. The completion of the Internal Market is seen as an economic modernization necessity and walks in pair with deregulation (towards a “single” market) or re-regulation at the EU level. Some have attempted to explain this apparent contradiction by the dis-embeddedness of the economic and the social dimensions in European integration, the economic being an EU competence while social policy being the exclusive choice of the Member States²⁸⁶. Others have more optimistically referred to the growing social regulation produced by the EU as an attempt to embed the Internal market to a new social framework that is independent from the nation-state²⁸⁷. Yet despite the experimentation of the EU in social regulation (to be distinguished from the concept of social policy²⁸⁸), this remains a

²⁸⁵ M. Monti, *A New Strategy for the Single Market*, *ibid.*, (9 May 2010)

²⁸⁶ F. Schrapf, ‘Economic Integration, Democracy, and the Welfare State’, *JEPP*, vol. 4 issue 1, (1997) 18-36.

²⁸⁷ J. A. Caporaso and S. Tarrow, ‘Polanyi in Brussels: Supranational Institutions and the Transnational Embedding of Markets’, *International Organizations*, 63 (2009), 593-620.

²⁸⁸ G. Majone, ‘The European Community Between Social Policy and Social Regulation’, *JCMS*, vol. 31 issue 2, (1993) 153-170.

rather weak “countermovement” to the deregulatory paradigm shift brought by the Internal Market project²⁸⁹. The risk of a dis-embedded domineering market that will put an end to the “embedded liberalism²⁹⁰” post-war consensus and the subsequent national versions of it²⁹¹, constitutes the main source of fears and reactions to the “completion” of the Internal Market project.

It is interesting to pause a little on the conceptualization by the European institutions of the problems to which is faced the project of economic integration and explain why it has not yet been “completed”. In his report on the New Strategy for the Single Market, Mario Monti noted the emergence of an “integration fatigue”, eroding the appetite for a single market, as well as a “market fatigue”, leading to a reduced confidence in the role of the market. Both undermine the acceptance of the Internal market project by the European citizens²⁹². Monti clearly makes these comments in view of the dominant understanding of the aims of the single market as these were transcribed in the Commission’s White Paper on *Completing the Internal Market* in 1985 where it was indicated that

“the objective of completing the internal market has three aspects: [...] the welding together of the [...] markets of the Member States into one single market; [...] ensuring that this single market is also an expanding market; [...] ensuring that the market is flexible”²⁹³.

The Internal market was thus conceived of as an exercise of unifying and expanding markets, where all sorts of barriers, physical, technical, fiscal, would shade away. This dominant rhetoric is still present in the way the European Commission envisions the project of the Internal market, and more generally, economic integration. The rhetoric of “barriers” and their ever expanding definition, hardly dissimulates that convergence of prices and costs of production across the

²⁸⁹ According to K. Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Beacon Press, 1944 [2001]), p. 132, a “countermovement” is a movement against market forces using “the principle of social protection aiming at the conservation of man and nature ... using protective legislation, restrictive associations, and other instruments of intervention as its methods”.

²⁹⁰ J. G. Ruggie, ‘International regimes, Transactions, and Change: Embedded Liberalism in the Post-War Economic order’ *International Organization*, vol. 36 issue 2, (1982), 379-415.

²⁹¹ See the analysis of D. Bohle and B. Greskovits, ‘Neoliberalism, Embedded Neoliberalism and Neocorporatism: Towards Transnational Capitalism in Central-Eastern Europe’, *West European Politics* vol. 30 issue 3 (2007), 443-466.

²⁹² *Ibid.*, pp. 23-24.

²⁹³ *Ibid.*, p. 14 citing European Commission, *Completing the Internal Market*, COM(85)310 final.

Union constitutes the aim to achieve²⁹⁴. The Commission's report on the *State of the Internal Market for Services*, which served as the blueprint for the reforms introduced by the Services Directive is explicit on the identification of not only existing legal barriers to the development of services activities between Member States, but also of "non-legal barriers" which create "disincentives" for services trade, going from lack of information about the regulatory framework in other Member States to cultural/language differences and various consumer habits across the Union²⁹⁵. Barriers are ubiquitous and changing: they are no longer to be found in the body of legal texts but rather in administrative practices, in particular the discretionary power of appreciation left to national administrative authorities, they are the fact of regional or collective non-government rules and practices (in particular in the regulated professions) or of the conduct of individual operators that are still organizing their economic activities according to national boundaries²⁹⁶. One could imagine the extent of the Internal market project, should the need to "suppress" these "barriers" be followed literally.

This approach is certainly negating any space to pluralism and regulatory diversity. If the objective is to become one, the different governance arrangements are provisional steps towards the ineluctable end-game of the emergence of the integrated market. Harmonization versus pure market access principle becomes the only game in town. However, one could also find in the Commission's rhetoric, germs of a different perspective on the aims of the project of the Internal market.

Of particular interest is the analysis by the Commission in the *State of the Internal Market for Services* report of the "common origins of barriers". These are essentially

²⁹⁴ See, for instance, the assessment of financial integration by the European Commission, which employs two indicators –price and quantity. 'Price-based indicators include cross-country dispersions and measure discrepancies in prices that are related to the geographical origin of the services'. The Commission notes that, '(t)o the extent that financial products are comparable, an increase in integration should lead to higher convergence of prices and yields across countries'. The second category of indicators are quantity based and 'follow the principle that integration should lead users of financial services to diversify geographically and to shop beyond national boundaries' European Commission, Staff Working Paper Document, *European Financial Integration Report 2009*, SEC(2009) 1702 final, p. 7. See also the various impact assessment measures developed for the evaluation of the Services Directive: H. Kox and A. Lejour, 'The effect of the services directive on intra-EU trade and FDI', *Revue Economique*, vol. 57 issue 4 (2006), 747-769. On issues of measurement of the progress of regional integration processes, see P. de Lombaerde, 'Indicators of economic integration', *Statistika*, 4 (2008), 340-345.

²⁹⁵ European Commission, *Report from the Commission to the Council and the European Parliament on the State of the internal Market for Services*, COM(2002) 441 final, pp. 43-44.

²⁹⁶ *Ibid.*, pp. 45-51.

explained by three factors. The first one is the lack of mutual trust between the authorities of the different member states which leads to the “simple evocation of general good objectives to justify obstacles, without verifying the equivalence of the protection offered in the country of origin or the proportionality of the restriction” and the “automatic suspicion of services from other Member States”²⁹⁷. The main reason for this distrust is allegedly the “ignorance” of the implications of the principles of establishment and free provision of services, the lack of transparency and administrative cooperation between member states and the “lack of harmonisation of the national rules, reflected in an excessive (sic) disparity between the levels of protection of the general good guaranteed by the national systems”²⁹⁸. Secondly, the Commission advances as an additional reason for the persistence of barriers the resistance to modernisation of the national legal frameworks originating from the “slightly outdated” regulation in some Member States, the weak monitoring of the judgments of the Court and the absence of a systematic approach against barriers to trade. Finally, the defence of purely national interests, which is “firmly anchored in certain Member States” is advanced as a third explanatory factor for the pervasiveness of barriers to trade²⁹⁹.

Let’s take stock of these reasons for the “malaise” of the Internal market project. It is noteworthy that economic protectionism does not constitute the principal worry, as one would have expected. On the contrary, economic “modernisation” in the sense of liberalisation of trade and trust in the regulatory regime of other Member States are the focus of the Commission’s attention. One could venture that the goal of economic modernisation illustrates the mutation of the theoretical underpinnings of the Internal market project from a legal-rule based framework to a purely economic programme. But, at the same time, the reference to the necessary trust between national regulatory authorities offers a different conceptual background, where the problem is not so much the existence of domestic regulations, but rather the absence of interoperability between the different national regulatory systems. Regulatory compatibility and pluralism can thus be combined, under this view. What should be avoided is the absence of interconnection between the different national regulatory networks for reasons of distrust. The aim of the Internal market project becomes thus

²⁹⁷ Ibid., p. 54.

²⁹⁸ Ibid.

²⁹⁹ Ibid., at 55.

transformed from an operation of forced regulatory convergence through harmonization or Single market creation to an operation of establishing relations of trust between the different regulatory systems across the Union. Let the era of “regulatory peace” begin!³⁰⁰

This shift has profound consequences on the interaction between the concept of economic integration and pluralism. If the main problem faced by economic integration regimes is the distrust between national regulators, because of the risk of opportunistic behavior (cheating, breaking of trust), the different governance mechanisms cannot be thought of as constituting the different stages of a process of integration that leads ultimately to “convergence” of regulatory systems, or any form of centralized control (EU regulation or the “single” market’s forces of supply and demand). Regulatory sameness is not the only desirable outcome but a possible outcome among others. What counts is the potential of these governance arrangements in generating inter-organizational trust³⁰¹. Regulatory sameness and centralism constitute thus irrelevant variables to evaluate the progress of the project of economic integration. Less regulatory pluralism or less diversity do not necessarily qualify as progress in economic integration.

One could thus envision an opposition between two poles, trust and power/control/authority, where it would be possible to map the different governance mechanisms as leaning towards one pole or the other, under the assumption that they constitute different organizing principles in managing risk. Authority or power will be an organizing principle of interdependence and uncertainty by reallocating decision-making rights³⁰². Trust can be calculative and revolve around the idea of an advantageous cooperation where incentives for profit outweigh risk³⁰³.

Nevertheless, such a conceptualization overlooks that trust and power constitute functionally equivalent and not necessarily mutually exclusive means to reduce risk. Lane and Bachmann distinguish between “interaction-based power”, which derives from individually accumulated resources (size, economic power, political influence)

³⁰⁰ K. Nicolaidis, ‘Trusting the Poles Mark 2: Towards a Regulatory Peace Theory’, in this volume.

³⁰¹ On this concept, see I. Lianos and J. Leblanc, chapter 1, this volume.

³⁰² B., McEvily, V. Perrone and A. Zaheer, ‘Trust as an Organizing Principle’, *Organization Science*, vol. 14 issue 1 (2003), 91-103, p. 92.

³⁰³ O. E. Williamson, ‘Calculativeness, Trust and Economic Organization’, *Journal of Law and Economics*, vol. 36 issues 1 and 2, (1993) 453-486. Williamson mentions that calculated trust is ‘a subset of calculated risk’

and “system power”, which occurs in institutionalized form and “rests in collectively binding arrangements” that constraint “the options of opportunistic behaviour social actors might feel tempted to explore”³⁰⁴. The aim of “system power” is to generate “system trust”, that is “to encourage social actors to trust each other on the grounds of collectively binding rules which reduce the risk of trust”³⁰⁵. These can be enforced through an “institutionalized threat of collective sanctions” or a more informal mechanism, such as the use of hostages, a balance of mutual dependence, reputation costs. If the actors have a relationship of repeated interaction with a significant degree of interdependence the latter can be equally effective in reducing the risks of cooperation. For example, as EU Member States have a relation of repeated interaction and a significant degree of interdependence, reputation costs in case of non-performance are extremely high. This may progressively lead to weaken the case for establishing formal institutions with a power to impose sanctions, through the means of hard law, and may favour the reliance on cooperation mechanisms, based on trust, such as networks or soft law, in sectors where the establishment of formal institutions, monitoring, safeguarding and formal controls may be costly (because of negotiation costs, monitoring and compliance costs).

It follows that trust and power/control cannot only be treated as substitutes but may also operate as complements in the context of the specific relationship of interdependence between organizations³⁰⁶. Yet this picture would be incomplete if one takes exclusively into account inter-organizational trust between Member States and does not include the other facets of “total trust”³⁰⁷: the trust between Member States as principals of the integrated EU institutions they put in place or trust in government, that is the confidence of citizens/economic operators to their government and EU institutions. The trust game is thus more complex as each actor aims to increase its trustworthiness at different levels. For example, even if we conceive that the EU institutions, such as the European Commission and the European Court of Justice, are acting as agents of Member States, we are not in a system with one or few principals but they face 27 diverse principals with different regulatory settings. In the absence of hegemonic control or veto power, each of the

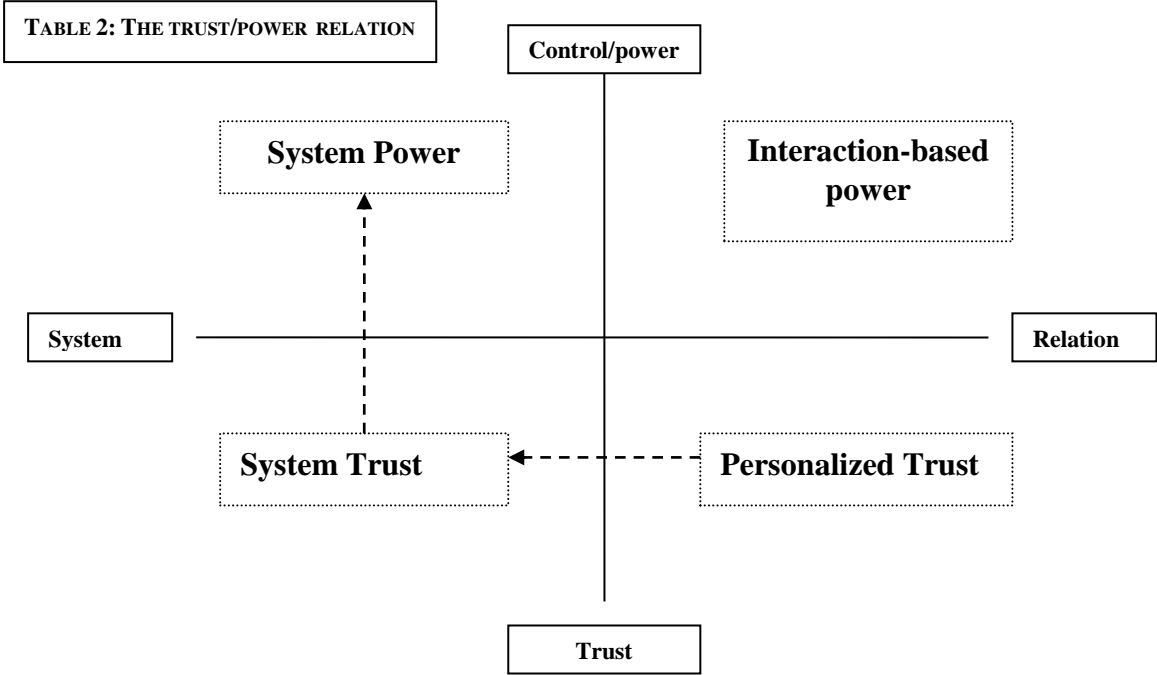
³⁰⁴ C. Lane and R. Bachmann, ‘Co-operation in Inter-Firm Relations in Britain and Germany: The Role of Social Institutions’, *The British Journal of Sociology*, vol 48 (2) (1997), 226-254, p. 232.

³⁰⁵ Ibid.

³⁰⁶ B. Nooteboom, *Trust* (Edward Elgar; Cheltenham, 2002), pp. 11-12.

³⁰⁷ On this concept, I.Lianos and J. Leblanc, chapter 1, this volume.

principal thus retains only a small fraction of control of the agent and consequently it is more difficult and costly to hold agents to account³⁰⁸. In any case each governance mechanism will dither between the following four poles: system power, system trust, personalized trust and “interaction-based” power.



The focus on trust preserves the integrity of the governance system in as much as personalized trust facilitates system trust. It is easier to cooperate and move to a system of mutual recognition if there is some degree of familiarity or similarity with the partner’s regulatory system. System trust also contributes to the emergence of system power when the risks of cooperation are substantial and justify the costs of establishing an heterarchical or hierarchical structure of monitoring and control, as is the case for regulatory harmonization (regulatory networks) or harmonization respectively.

This approach is not the right one because it dissociates integration from centralism and thus preserves pluralism. It is also compatible with the evolution of EU integration and the emergence of hybrid governance mechanisms that challenge the existing conceptual categories of negative and positive integration or the market access/mutual recognition and harmonization triad. The centrality of the mutual

³⁰⁸ N. Krisch, ‘Global Administrative Law and the Constitutional Ambition’, *LSE Law, Society and Economy Working Papers* 10/2009, p. 4.

recognition principle in the process of governance of the European internal market illustrates also a shift from the focus on centralism and uniformity towards managing diversity through regulatory interoperability, or as Kalypso Nicolaidis puts it in this volume, an era of “regulatory peace”³⁰⁹ that accommodates regulatory pluralism.

IV. Conclusion

The opposition of constitutionalists and pluralists accounts of post-national law has been an important trend of recent EU law and integration scholarship³¹⁰. Transposing this debate to the economic integration realm one could establish an analogy with the tensions between the integrationist tendency of the proponents of an “economic constitution” and the poly-archival conception of regulatory pluralism. These were initially accommodated by the decoupling of the economic and the social dimensions of integration and the institution of a functional pluralism where the decision-maker power for social policy was allocated at the national level and that of economic and trade liberalization at the European level. Such dichotomy was of course transitive and operated as long as the economic effects of trade liberalization did not affect negatively the interests of powerful domestic groups. The assumption was that a “countermovement” will take place at the national level in order to compensate the affected domestic groups for the distributive consequences engendered by the process of trade liberalization.

However, the hierarchical structure of the EU legal order and its underlying monist constitutional dimension led to the emergence of intense normative conflicts between the logic of economic integration, perceived as trade liberalization, and that of national conceptions of social or distributive justice. Responding to this pressure, the realm of EU action was progressively extended to cover the field of social

³⁰⁹ K. Nicolaidis, ‘Trusting the Poles Mark 2: Towards a Regulatory Peace Theory’, in this volume.

³¹⁰ N. McCormick, *Questioning sovereignty? Law, State and Nation in the European commonwealth* (Oxford: OUP, 1999); N. Walker, ‘The Idea of Constitutional Pluralism’, *MLR*, 65 (2002), 317-359; N. W. Barber, ‘Legal Pluralism and the European Union’, *ELJ*, 12 (2006), 306-329; M. P. Maduro, ‘Contrapunctual Law: Europe’s Constitutional Pluralism in Action’, in: N. Walker (ed.), *Sovereignty in Transition: Essays in European Law* (Oxford: Hart, 2003), 501; N. Krisch, ‘The Case for Pluralism in Postnational law’, *LSE Law, Society and Economy Working Papers* 12/2009; P. Eleftheriadis, ‘Pluralism and Integrity’, *Legal Research Paper Series*, (University of Oxford, October 2009) Paper No. 43/2009, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1486151 .

regulation³¹¹, thus slowly overthrowing the dichotomy between the economic and the social dimension of European integration. As the social dimension was becoming part of the EU realm, the functional pluralism was replaced by a horizontal regulatory pluralism operating across different national regulatory systems, each of them attempting to influence the emerging social regulation system at the EU level, as a way to preserve the national arrangements and eventually to expand them in other jurisdictions.

Yet the hard and fundamental character of legal norms protecting the principle of free movement in the EU legal framework, as well as the transformation of the political project of Internal market to a broader economic modernization venture, with the initiation of far reaching reforms of national welfare systems, following the Lisbon agenda, signalled that the balance between trade and social protection to be achieved at the EU level would be politically unacceptable to a number of Member States and interest groups. The demands for social Europe that culminated with the reactions to the proposals for the Services Directive and the fear that eastward enlargement will spur a race to the bottom for social welfare systems led to a more vocal affirmation of the principle of regulatory pluralism.³¹² As was examined in Part I, regulatory diversity and “policy space” accommodating the Member States’ various social and regulatory traditions made its entrance to the monolithic and market integration focused jurisprudence of the ECJ as well as to EU harmonization efforts.

The turn from market access and harmonization to the principle of mutual recognition encapsulates this recognition of regulatory pluralism as, at least a descriptive claim, for EU integration. Taking stock of regulatory pluralism thus carries an acceptance of the various structures of policy institutions and accordingly the diverse substantive regulatory outcomes across Member States in terms of policy production. Yet, the existence of cross-border negative domestic policy externalities requires some form of coordination among the plurality of regulatory systems that compose the EU. Here the analogy between regulatory pluralism and constitutional pluralism loses its appeal. Accounts of pluralism by constitutional/institutional law theorists emphasize the conflict of values between the whole and the parts as the main problem faced by a pluralistic legal order or the interaction between various

³¹¹ We use “social regulation” in the broad sense, thus also including environmental regulation.

³¹² N. Lindstrom, ‘Service Liberalization in the Enlarged EU: A Race to the Bottom or the Emergence of Transnational Political Conflict?’, *JCMS*, 48(5) (2010), 1307-1327.

heterarchical legal orders. Some offer overarching substantive principle or norms in order to resolve conflicts, such as subsidiarity, due process and democracy³¹³. Others prefer a jurisdictional framework and the application of conflict of law rules³¹⁴ or some form of subject matter dualism and mutual respect between legal orders³¹⁵. Others suggest a procedural framework, that of “contrapunctual law” requesting from each system to integrate each other’s concerns by communicating them and, more importantly, by integrating their different claims of validity within the context of a coherent and integrated European legal order³¹⁶.

This study has defended a different perspective than that of managing values or regulatory conflicts. The emphasis has been on the establishment of institutions, formal and informal, with the aim to manage the risks of cooperation between diverse regulatory systems. Likewise, the hypothesis was that the emergence of different governance mechanisms in the regulation of trade in services entails that the risks of cooperation are variable. The latter depend on the degree of interaction between the Member States and the existence of regulatory pluralism. By disentangling the focus of integration from managing or suppressing conflicts and thus regulatory diversity to establishing system trust between the different components, Member States, European institutions, economic operators and citizens, the trust theory of integration, defended in this study, offers real chances to regulatory pluralism in the EU.

³¹³ M. Kumm, ‘The Legitimacy of International Law: a Constitutionalist Framework of Analysis’, *EJIL*, 15 (5) (2004), 907-931.

³¹⁴ See, C. Joerges and F. Roedl, ‘Reconceptualising the constitution of Europe’s post-national constellation – by dint of conflict of laws’, in this volume.

³¹⁵ P. Eleftheriadis, ‘Pluralism and Integrity’, *Legal Research Paper Series*, (University of Oxford, October 2009,) Paper No. 43/2009, 21-28.

³¹⁶ M. P. Maduro, ‘Contrapunctual Law: Europe’s Constitutional Pluralism in Action’, in: N. Walker (ed.) *Sovereignty in Transition* (Oxford: Hart, 2003), 501, pp. 529-530.