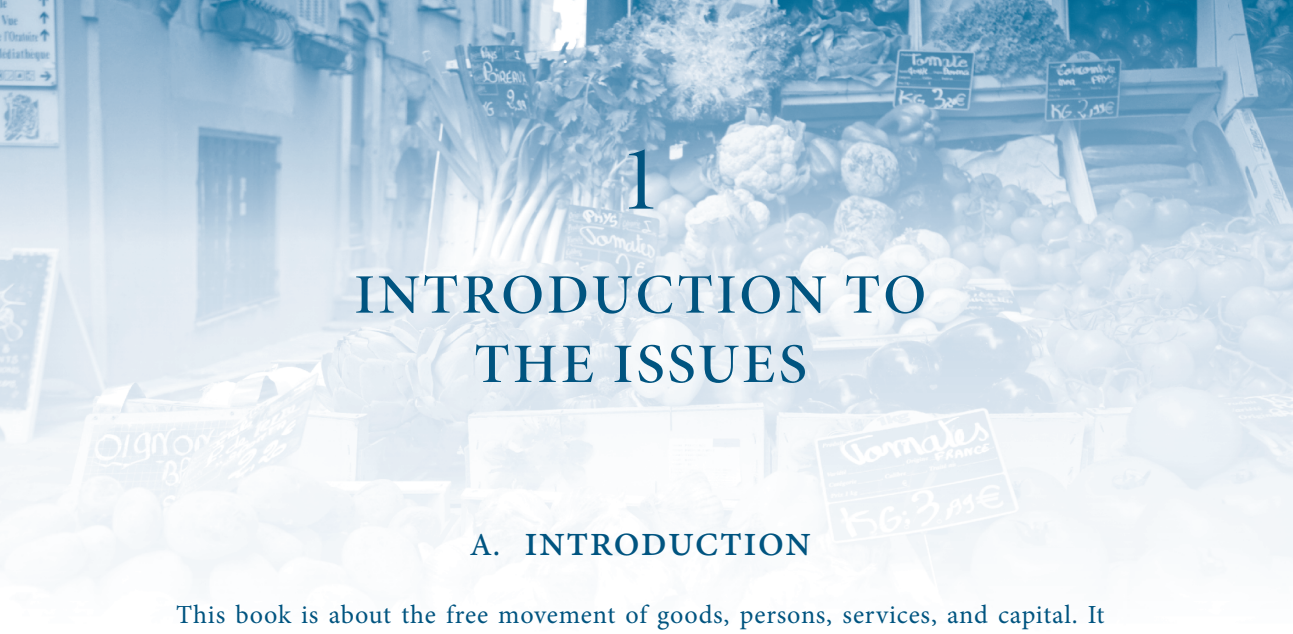
PART I

INTRODUCTION



1
INTRODUCTION TO THE ISSUES

A. INTRODUCTION

This book is about the free movement of goods, persons, services, and capital. It focuses principally on the rules interfering with movement from one Member State to another. To a lesser extent, it also examines the rules regulating those producers or people wishing to enter the European Union. The aim of this chapter is to place these rules in context. Why has the EU set about this policy of facilitating free movement? Who benefits, and who loses? What are the conditions necessary for free movement? And what is the ultimate objective of such policies? To begin with we start by examining the age-old question, why is free trade important? In the interests of maintaining the economic, political, and social integrity of the nation state, why not simply seal off national borders, keep out foreign goods, and protect national industries and national jobs?

B. THE IMPORTANCE OF FREE TRADE

1. INTRODUCTION

The benefits of free trade can be summarized briefly—free trade allows for specialization, specialization leads to comparative advantage, and comparative advantage leads to economies of scale which maximize consumer welfare and ensure the most efficient use of worldwide resources. In his famous treatise on the *Wealth of Nations*, the classical economist Adam Smith noted, 'It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy … What is prudence in the conduct of every private family, can scarce be folly in that of a great kingdom.'[1] Two hundred years later, the Leutwiler report,[2] prepared for GATT, reflected similar sentiments: '[a] farmer may know how to sew and a tailor may know how to raise chickens—but each can

[1] A. Smith, *The Wealth of Nations* originally published in 1776, Bk IV, Ch. II cited in P. Kenen, *The International Economy*, 4th edn (Cambridge: CUP, 2000), 9. Kenen himself says (at 20) that 'In a world of competitive markets, trade will occur and will be beneficial whenever there are international differences in relative costs of production.'

[2] The Leutwiler report of 1985 prepared for GATT, *Trade Policies for a Better Future: Proposals for Action* (Geneva: GATT, 1985), 23, cited in J. H. Jackson, *The World Trading System: Law and Policy of International Economic Relations*, 2nd edn (Cambridge, Mass.: MIT Press, 1997), 12.

produce more by concentrating on doing what each can do most efficiently'. Since trade allows countries to concentrate on what they can do best and, since no two countries are exactly alike in natural resources, climate, or workforce, those differences give each country a comparative advantage over the others in the same products.[3] Trade translates the individual advantages for many countries into maximum productivity for all.

2. THE THEORY OF COMPARATIVE ADVANTAGE

The theory of comparative advantage was developed by Ricardo in 1817,[4] using the example of wine and cloth production in the UK and Portugal. Jackson explains the operation of the model in the following terms.[5] In the UK it takes five hours of labour to produce a yard of cloth and ten hours a gallon of wine; in Portugal it takes ten hours of labour to produce a yard of cloth and six hours a gallon of wine. In these circumstances the UK has an *absolute* advantage in cloth production and Portugal has an *absolute* advantage in wine production. In the absence of trade (the so-called 'autarky' case), both countries will have to produce a mix of wine and cloth even though the UK is better at producing cloth and Portugal better at producing wine. Assuming an availability of 90 hours' labour then the total amount of wine and cloth produced in the UK and Portugal is 13 yards of cloth and 14 gallons of wine. This is summarized in table 1.1.

Table 1.1 Absolute advantage (autarky case)

	UK	Portugal	Total
Cloth	10 yds	3 yds	13 yds
	(10 × 5 hrs = 50 hrs)	(3 × 10 hrs = 30 hrs)	
Wine	4 gallons	10 gallons	14 gallons
	(4 × 10 hrs = 40 hrs)	(10 × 6 hrs = 60 hrs)	

However, if trade is opened up between the UK and Portugal (the so-called 'cosmopolitan case') and each state is allowed to specialize, then 18 yards of cloth and 15 gallons of wine can be produced, again assuming 90 hours of available labour (table.1.2).

Table 1.2 Absolute advantage (cosmopolitan case)

	UK	Portugal	Total
Cloth	18 yds	0 yds	18 yds
	(18 × 5 hrs = 90 hrs)		
Wine	0 gallons	15 gallons	15 gallons
		(15 × 6 hrs = 90 hrs)	

[3] The Leutwiler report of 1985 prepared for GATT, *Trade Policies for a Better Future: Proposals for Action* (Geneva: GATT, 1985), 23, cited in J. H. Jackson, *The World Trading System: Law and Policy of International Economic Relations*, 2nd edn (Cambridge, Mass.: MIT Press, 1997), 12.

[4] D. Ricardo, *On the Principles of Political Economy and Taxation*, 3rd edn (London: John Murray, 1821), Ch. 7 with the definitive version appearing in P. Sraffa (ed.), *The Works and Correspondence of David Ricardo* (New York: CUP, 1953).

[5] This is taken from Jackson, n. 2, 15. A more detailed analysis can be found in Kenen, see n. 1, 47–61.

From this we can see that specialization results in higher total productivity.

Even where one country has an absolute advantage in respect of *both* goods there is still an advantage in specialization. For example, if, in the UK, it takes five hours of labour to produce a yard of cloth and ten hours to produce a gallon of wine, while in Portugal it takes ten hours of labour to produce a yard of cloth and ten hours to produce a gallon of wine then, again assuming 90 hours of labour, table 1.3 shows production levels in the autarky case.

Table 1.3 Comparative advantage (autarky case)

	UK	Portugal	Total
Cloth	10 yds	5 yds	15 yds
	(10 × 5 hrs = 50 hrs)	(5 × 10 hrs = 50 hrs)	
Wine	4 gallons	4 gallons	8 gallons
	(4 × 10 hrs = 40 hrs)	(4 × 10 hrs = 40 hrs)	

If trade is opened up between the UK and Portugal then table 1.4 shows production levels in the cosmopolitan case.

Table 1.4 Comparative advantage (cosmopolitan case)

	UK	Portugal	Total
Cloth	18 yds	0 yds	18 yds
	(18 × 5 hrs = 90 hrs)		
Wine	0 gallons	9 gallons	9 gallons
		(9 × 10 hrs = 90 hrs)	

Even in the case of the UK having an absolute advantage in respect of both wine and cloth, there is an advantage for the two countries to trade if the *ratio* of production costs of the two products differs. Thus, in the second example, a gallon of wine in the UK costs two yards of cloth, whereas in Portugal it costs only one yard of cloth. It is therefore worthwhile for the UK to produce cloth and trade its excess for wine. Thus, as Jackson points out,[6] it is not the difference of absolute advantages but of comparative advantage that gives rise to gains from international trade.

These examples show that with specialization comes greater productivity and that ultimately free trade should lead to cheaper products for the British and Portuguese consumer and greater choice. If supply and demand can be brought into equilibrium, then *static* or *allocative* efficiency will be maximized (the wants or preferences of the various parties will have been satisfied to the greatest possible extent). Putting it another way, the welfare of consumers is maximized since they spend less of their finite resources on buying the goods they need. At a micro-level, employment is secure for workers making cloth in the UK and wine in Portugal, with the important social consequences that ensue from this security. It also means that employers should put in place good terms and conditions of employment

[6] See n. 2, 16.

in order to retain a skilled workforce who can meet the demand for their products. Thus, social benefits will arise as a consequence of free trade.[7] Indeed, going beyond Ricardo, specialization, competition, and access to larger markets should bring the incentive to invest in production facilities and thus greater economies of scale.

The economic benefits of operating in a wider market were spelled out in the Spaak report drawn up by the heads of delegation to the foreign affairs ministers prior to the signing of the Treaty of Rome. They noted that in such a market it would no longer be possible to continue with outdated modes of production which lead to high prices and low salaries. Instead of maintaining a static position, enterprises would be subject to a constant pressure to invest in order to develop production, improve quality, and modernize methods of exploitation. It would be necessary to progress to stand still.[8]

Free trade produces another consequence of great importance: the two nations, Portugal and the UK, are now dependent on each other for goods. The prosperity of the countries is enhanced, boosting the prospects for peace at home and also peace between the two trading nations: countries trading peacefully are less likely to go to war. This was Monnet's vision for the European Union.

3. THE PROBLEMS WITH THE BASIC MODEL

Ricardo's model is premised on a situation of perfect competition with no state intervention in the market. Economists make a number of assumptions about such markets:[9] buyers and sellers act rationally, are numerous, have full information about products on offer, can contract at little cost, have sufficient resources to transact, can enter and leave the market with little difficulty, and will carry out the obligations which they agree to perform. Under these assumptions market participants should continue to trade until no gains can be realized from further exchange. The distribution is *allocatively efficient*: assets are being employed in their most highly valued use.

Of course, the real world is not like this; the conditions of perfect competition do not exist in any market, not just transnational markets such as the EU's. For example, information failure, transaction costs, and the tendency of actors to shirk commitments are issues in all markets, albeit that the problems are exacerbated in the transnational context. However, there are certain problems which are associated with transnational markets which do not affect national markets in the same way. For example, national regulators tend to respond to local concerns, ignoring the external costs of their regulation, by generating trade barriers and granting inefficient subsidies. This can be seen in the following illustration.

In the process of achieving allocative efficiency, some, if not all, British wine makers go out of business, as do Portuguese cloth makers. This is the politically and socially difficult face of any free trade regime. In a democratic society governments, needing to be re-elected, respond to public pressure about the actual or potential loss of domestic jobs caused by

[7] This was recognized in Art. 151 TFEU which provides that Member States believe that an improvement in working conditions 'will ensue not only from the functioning of the internal market … but also … from the approximation of provisions laid down by law, regulation or administrative action.'

[8] Author's translation of the Spaak report, Brussels, 21 Apr. 1956, Mae 120 f/56, 14.

[9] These are summarized by B. Cheffins, *Company Law: Theory, structure and operation* (Oxford: Clarendon Press, 1997), 6.

cheap imports. In the absence of any external restraining factor, they may put up trade barriers. So, under pressure from the Portuguese cloth industry, the Portuguese government might try to prevent the import of British cloth or at least limit the quantity of British cloth imported from the UK by issuing a limited number of import licences. These are quantitative restrictions on trade (QRs). Alternatively, the Portuguese government might lay down quality or other standards for the cloth sold in Portugal or it might allow Portuguese cloth producers to register a trade mark. Such steps are referred to as measures having an effect equivalent to quantitative restrictions (MEEs). These so-called non-tariff barriers (NTBs) may serve protectionist purposes (which would be condemned in a free trade regime) or they may further other, more legitimate, objectives such as consumer protection.

Any such action taken by the state might be reinforced by action taken by private parties: Portuguese cloth manufacturers might agree that they will supply cloth to wholesalers who agree to stock only Portuguese cloth. Such restrictions will inevitably reduce the gains from free trade.

The UK government might decide to retaliate by adopting fiscal measures designed to impede the import of Portuguese wine. It might impose customs duties (CDs) or other charges on the imported goods which have an equivalent effect to customs duties (CEEs). These tariff barriers would have the effect of making the Portuguese wine more expensive, as would taxing Portuguese wine at a higher rate than British wine or a rival product widely produced and consumed in the UK, such as beer. At the same time the Portuguese government might try to prop up its ailing domestic cloth industry by giving it large financial handouts (state aids) paid for by Portuguese taxpayers. It might also adopt a government purchasing policy based on the idea of buying national goods in preference to the cheaper imports. Once again, the taxpayer is footing the bill for a policy dictated not by economic efficiency but political necessity.

One way to remove such barriers is for the Portuguese and British governments to enter a bilateral agreement removing trade restrictions and requiring each Member State to recognize the goods produced by the other. If more states are involved, they might decide to set up a central institution to check that all participants are playing by the rules, a body whose decisions are binding on the national governments and take precedence over conflicting national laws. Ultimately, this body might begin to set the rules to deal with the problems of market failure which are specific to the transnational context. This then raises questions about the role of law in such an institutional arrangement and the legitimacy and accountability of the rule-making body. To maximize the benefits of free trade, such grouping needs to be global. The World Trade Organization (WTO) represents an important step in this direction. However, in the absence of global free trade, regional groupings (such as the EU) have formed which have tried to obtain the benefits of free trade from among a smaller number of states.[10] The classical thinking is that since worldwide free trade will maximize global welfare, so a smaller grouping must be the next best thing.[11] We turn now to consider what form these groupings might take.

[10] This is recognized by Art. XXIV (8) of GATT.

[11] This does not always occur if a Customs Union leads to trade diversion (replacement of cheaper imports from the outside world by more expensive imports from a partner): W. Molle, *The Economics of European Integration: Theory, Practice and Policy*, 5th edn (Aldershot: Dartmouth, 2006), 84.

C. THE DIFFERENT STAGES OF INTEGRATION

1. INTRODUCTION

Economists have developed a number of labels to describe different levels of intensity of market integration (see Box 1).[12] Each of these forms of integration can be introduced in its own right; they are not necessarily stages in a process which eventually leads to full union.[13]

Box 1 DIFFERENT STAGES OF INTEGRATION[14]

- *Free Trade Area (FTA)*—Member States remove all impediments to free movement of goods among themselves but each state retains the autonomy to regulate its trading relations with non-Member States
- *Customs Union (CU)*—FTA + common external policy in respect of non-Member States (e.g., single customs tariff)
- *Common Market (CM)*—CU + free movement of persons, services, and capital
- *Monetary Union (MU)*—CM + single currency
- *Economic Union*—MU + single monetary and fiscal policy controlled by a central authority
- *Political Union (PU)*—Economic Union + central authority sets not only monetary and fiscal policies but is also responsible to a central parliament with the sovereignty of a nation's government. Such a parliament might also set foreign and security policies
- *Full Union (FU)*—the complete unification of the economies involved and a common policy on matters such as social security, income tax.

We shall now consider where the EU fits into these stages of integration.

2. FREE TRADE AREA AND CUSTOMS UNION

An FTA is characterized by a common internal policy (the free movement of goods between participating states) but different external policies (each state retains the competence to regulate trade with non-members). Loosely speaking, this describes the position in the European Free Trade Area (EFTA) and the North American Free Trade Area (NAFTA). The disadvantage of a free trade area is that goods coming from non-Member States will enter the area via the state with the most favourable trading regime (usually the one with

[12] On the need to provide an economics analysis of issues of international trade, see R. Cass, 'Introduction: Economics and international law' in J. Bhandari and A. Sykes (eds.), *Economic Dimensions in International Law: Comparative and empirical perspectives* (Cambridge: CUP, 1997).

[13] A. El-Agraa, *The Economics of the European Community*, 4th edn (Hemel Hempstead: Harvester Wheatsheaf, 1994), 2.

[14] These stages are all derived from B. Balassa, *The Theory of Economic Integration* (London: Allen and Unwin, 1961). See also W. Molle, at n. 11, 10–11; P. VerLoren van Themaat, 'Some preliminary observations on the IGC: The relations between the concepts of a common market, a monetary union, an economic union, a political union and sovereignty' (1991) 28 *CMLRev.* 291.

the lowest tariffs) and then, taking advantage of the rules on free movement, benefit from the free circulation of its goods within the area.[15] A CU can overcome these problems. It is similar to an FTA internally but differs from an FTA externally because participating states have a common policy in respect of the non-members.

According to Article 28(1) TFEU, the EU comprises a CU where customs duties are prohibited between Member States and a common customs tariff (CCT) is adopted in respect of third countries. However, EU law has gone further than classical economic theory might expect by also prohibiting the use of non-tariff barriers, i.e. quantitative restrictions (QRs) which in welfare terms can be just as damaging to free trade without the revenue-producing benefits, and measures having equivalent effect (MEEs) (Articles 34–5 TFEU). The EU also prohibits anti-competitive behaviour by private actors which might attempt to resurrect barriers to trade which partition the market on national lines (Articles 101–2 TFEU), as well as state aids (Article 107 TFEU).

3. COMMON MARKET, SINGLE MARKET, AND BEYOND

3.1. The Common Market

An FTA and a CU focus on the free movement of *products*. A common market allows for free movement of *production* factors (workers and capital) as well as products. The idea is that the liberalization of factors of production allows for the optimum allocation of labour and capital. If production factors are missing from a place where production would be most economical, entrepreneurs in a common market can shift their capital from places of low return to states which have more potential.[16] Similarly, labour can move from areas of high unemployment to areas of high employment. Ultimately this should lead to the equalization of prices.

This can be seen in the following example. Let's imagine that in Portugal labour is plentiful but capital is scarce and in the UK capital is plentiful but labour is scarce. Assuming that wine is relatively labour-intensive and cloth relatively capital-intensive, then wine will be cheaply produced in Portugal and cloth in the UK. In an FTA or CU, Portugal will export wine and the UK will export cloth. As we saw from table 1.2, Portugal will shift resources from the manufacture of cloth to wine while the UK will shift resources from the manufacture of wine to cloth. However, in a *common market* the goods *or* the factors of production can move. If the factors of production move then workers migrate from Portugal to the UK where they can earn more, and capital flows from the UK to Portugal. This will alter the relative scarcities of the two production factors in the UK and Portugal and thus equalize their prices.[17] This will reduce the cost differences between the two countries in the production of wine and cloth, thus removing the stimulus to trade in these goods.

This suggests that there is a relation of substitution between the movement of products and the movement of factors of production. Yet, as Molle points out, however interesting the results of substitution in theory, it is not very helpful for practical purposes, since its assumptions rarely hold good: markets are not characterized by perfect competition, factors are not perfectly mobile, and countries are differently endowed with natural resources. Thus, it is more likely that free movement of products and free movement of production

[15] This can be addressed in part through a system of certificates of origin. See, further, Molle, at n. 11, 10.
[16] Molle, at n. 11, 13. [17] Molle, at n. 11, 169.

factors are *complements*, not substitutes. As we shall see, free movement of goods is particularly important to the EU since in practice it is easier for goods to move to people than people to goods.

The creation of a common market lay at the heart of the European Community (now European Union) project. Article 2 EC (now repealed) said that the (then) Community had as its task the establishment of a common market (Article 3(3) TEU continues to provide that 'The Union shall establish an internal market' which is defined in Art. 26 TFEU), and one of the activities of the Community listed in Article 3 EC (now repealed) was the creation of 'an internal market characterized by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital'.

The detail of these four freedoms are found in specific Articles of the Treaty: Articles 34–5 TFEU on goods, Article 45 TFEU on workers, Article 49 TFEU on establishment, Articles 56–7 TFEU on services, and Article 63 TFEU on capital. These Articles are based on the principle of *negative* integration—removing barriers to trade. As the Court put it in *Gaston Schul*,[18] the aim of the provisions of the Treaties is to eliminate 'all obstacles to intra-[Union] trade in order to merge the national markets into a single market bringing about conditions as close as possible to those of a genuine [domestic][19] market'.

3.2. The Single Market

By the mid 1980s Euro-sclerosis had set in and the failure of the common market was plain for all to see. In 1985 Jacques Delors, the president of the European Commission, responded with his ambitious plan for the single market.[20] A White Paper, *Completing the Internal Market*,[21] was drawn up under the direction of the British commissioner, Lord Cockfield, which focused on removing barriers which continued to prevent free movement.[22] It identified three principal obstacles to the completion of the single market:

- physical barriers to trade—e.g., intra-EU border stoppages, customs controls, and associated paperwork
- technical barriers to trade—e.g., meeting divergent national product standards adopted for health and safety reasons or for consumer and environmental protection, other technical regulations, conflicting business laws, entering nationally protected public procurement markets[23]
- fiscal barriers to trade—especially differing rates of VAT and excise duties.

[18] Case 15/81 *Gaston Schul Douane Expediteur BV* v. *Inspecteur der Invoerrechten en Accijnzen, Roosendaal* [1982] ECR 1409, para. 33.

[19] The original quotation reads 'internal'. Earlier case law (e.g., Case 270/80 *Polydor* v. *Harlequin* [1982] ECR 329, para. 16) talks of 'domestic' market, and this term has been used for the sake of clarity.

[20] C. Grant, *Delors: Inside the house that Jacques built* (London: Nicholas Brealey Publishing, 1994), 66.

[21] COM(85)310. See H. Schmitt von Sydow, 'The basic strategies of the Commission's White Paper' in R. Bieber et al., *1992 One European Market? A critical analysis of the Commission's internal market strategy* (Baden-Baden: Nomos Verlagsgesellschaft, 1988).

[22] Lord Cockfield, *The European Union: Creating the single market* (Chichester: Wiley Chancery, 1994), 39.

[23] P. Cecchini, *The European Challenge 1992: The benefits of a single market* (Aldershot: Wildwood House, 1988), 4. These problems persist: see the Commission's Internal Market Package (COM(2007)35) discussed in Ch. 4.

The Cecchini Report on the Cost of Non-Europe[24] anticipated that the growth resulting from the single market would put between four and seven percentage points on the Union's domestic product and the creation of between two and five million new jobs.

The White Paper then identified 300 measures (the final count was actually 282) necessary to complete the single market. The Single European Act (SEA) 1986,[25] the first significant Treaty amendment after the Treaty of Rome, provided the necessary means to achieve these objectives. It introduced a new legal basis, Article 114 TFEU, which provided for qualified majority voting when enacting measures for the approximation of Member States' laws which have as 'their object the establishment and functioning of the internal market'. While the original EEC Treaty had also envisaged a role for *positive integration* (harmonization) the legal bases provided, notably Articles 115 and 352 TFEU, required unanimous voting in Council, and this hindered their utility as a means of adopting a large number of, often controversial, measures deemed necessary to complete the internal market. The introduction of Article 114 TFEU emphasized that the single market was essentially a law-making project. This raises the issue as to the type of (supranational) laws the EU requires. This question is considered in detail in Chapter 16.

The SEA also introduced Article 100b EEC which required the Commission, together with each Member State, to draw up an inventory of national measures which fell under Article 100a EEC (now Article 114 TFEU) and which had not been harmonized. The Council could then decide whether the provisions in force in a Member State could be recognized as being equivalent to those in another Member State. This power was not used and Article 100b was abolished by the Amsterdam Treaty.

For presentation purposes, the SEA repackaged the four freedoms into the renamed 'internal' or 'single' market and, in Article 7a EEC (now Article 26 TFEU), set a new deadline by which they were to be achieved: 31 December 1992.[26] While the deadline was psychologically and politically significant,[27] it had no legal effect.[28] The name change, from 'common' to 'single' or 'internal' market, also had little effect. At first glance, the term 'single market' appears narrower than 'common market' because the single market is defined by reference only to the four freedoms while the common market combines the four freedoms

[24] P. Cecchini, *The European Challenge 1992: The benefits of a single market* (Aldershot: Wildwood House, 1988), xvii–xviii.

[25] For critical comment on the SEA see P. Pescatore, 'Some critical remarks on the Single European Act' (1987) 24 *CMLRev*. 9: 'the implementation of the Act [represents] … on the whole a major setback for the European Communities … It … [would be] better for our future together … if we were to abandon this ill-fated experiment.' For a more positive reaction, see D. Edwards, 'The impact of the Single Act on the Institutions' (1987) 24 *CMLRev*. 19.

[26] The deadline is merely noted in Case C–9/99 *Echirolles Distribution SA* v. *Association du Dauphiné* [2000] ECR I–8207. The deadline of 31 Dec. 1992 has been removed from Art. 26 TFEU. Article 26 TFEU remains significant for steering the interpretation of the four freedoms: Case C–102/09 *Camar* v. *Presidenza del Consiglio dei Ministri* [2010] ECR I–4045, para. 33

[27] It represented the life span of two four-year Commissions. The original EC Customs Union was to be completed over three periods of four years. It was in fact completed in just over ten years in 1967.

[28] The declaration attached to the Article by the SEA said that the participants expressed their 'firm political will' to complete the internal market before 1 Jan. 1993 but that setting the date of 31 Dec. 1992 did not create 'an automatic legal effect'. See H. Schermers, 'The effect of the date 31 December 1992' (1991) 28 *CMLRev*. 275. See also A. Toth, 'The legal status of the declarations attached to the Single European Act' (1987) 24 *CMLRev*. 803. In Case C–378/97 *Criminal Proceedings against Wijsenbeek* [1999] ECR I–6207, para. 40, the Court observed that Art. 14 EC (now Art. 26 TFEU) could 'not be interpreted as meaning that, in the absence of measures adopted by the Council before 31 Dec. 1992 requiring the Member States to abolish controls of persons at the internal frontiers of the [Union], that obligation automatically arises from expiry of that period'.

with flanking measures such as agriculture, competition, and social matters. In reality, the realization of the single market was, and is, dependent on further policy action in an ever-wider range of fields, including competition and social policy.[29] For this reason it is likely that the terms common, single, and internal market are largely synonymous.[30]

Although the deadline for the completion of the single market was 1992, in fact the single market is not yet complete. As the Commission puts it, creating a genuinely integrated market is not a finite task, but rather an ongoing process, requiring constant effort, vigilance, and updating. With technological and political developments, the environment in which the single market functions is changing all the time. Although many obstacles have been removed, others come to light and will continue to do so[31] and need to be addressed. For this reason the realization of the single market is an ongoing project, not a historical artefact.

3.3. Area of Freedom, Security and Justice

The Amsterdam Treaty introduced a new concept, the area of freedom, security, and justice (AFSJ). Article 67(1) TFEU says:

> The Union shall constitute an area of freedom, security and justice with respect for fundamental rights and the different legal systems and traditions of the Member States.

The rest of the Article explains the meaning of the three terms. 'Freedom' means the absence of *internal* border controls for persons and a common policy—on asylum, immigration, and external border control—in respect of third-country nationals (TCNs). 'Security' is about measures to prevent and combat crime, racism, and xenophobia, coordination and cooperation between police and judicial authorities and other competent authorities, as well as mutual recognition of judgments in criminal matters. Finally, the 'justice' element concerns access to justice, in particular through the principle of mutual recognition of judicial and extrajudicial decisions in civil matters.

The introduction of the AFSJ shows how the EU has undergone a shift from 'merely' establishing an internal market to creating an area of freedom, security, and justice which complements and goes beyond the stages of economic integration defined in Box 1.[32] The elision between the two policy objectives can be seen in Article 3(2) TEU which talks of the EU maintaining and developing 'an area of freedom justice and security *without internal frontiers*'[33] in which 'the free movement of persons is ensured in conjunction with appropriate measures with respect to external border controls, asylum, immigration and the prevention and combating of crime'. The AFSJ is considered in more detail in Chapters 12 and 14.

[29] The terminology of 'single market' has in fact been used by the Court since the early 1960s: e.g., Case 32/65 *Italy* v. *Council and Commission* [1966] ECR 389, 405; Case 15/81 *Gaston Schul* [1982] ECR 1409, para. 33.

[30] K. Mortelmans, 'The Common Market, the internal market and the single market, what's in a market?' (1998) 35 *CMLRev*. 101, 107. See also Tesauro AG in Case C–300/89 *Commission* v. *Council (titanium dioxide)* [1991] ECR I–2867: 'the concept of the "internal market" [is based] on that of the "common market"'.

[31] COM(2007)35, 6.

[32] S. Iglesias Sánchez, 'Free movement of third country nationals in the European Union? Main features, deficiencies and challenges of the new mobility rights in the area of freedom, security and justice' (2009) 15 *ELJ* 791, 795.

[33] Emphasis added.

4. ECONOMIC, MONETARY, AND POLITICAL UNION

The common market is at the heart of any economic, monetary, and political union. However, as Molle explains,[34] economic union also requires a high degree of coordination of economic policy, including macro-economic and monetary policies and possibly redistributive policies; while in a monetary union (MU) the currencies of the Member States are either linked through irrevocably fixed exchange rates and are fully convertible, or one common currency circulates in all Member States. Economic and monetary union combines the characteristics of economic union and monetary union and presupposes a high degree of coordination of macro-economic and budget policies. A political union (PU) goes further still, with integration extending beyond economics to include police, foreign policy, and security policy. Finally, the closest form of integration is full union (FU) which implies the 'complete unification' of the policies involved, and a common policy on such sensitive issues as social security and income tax. In these circumstances the situation of the union is virtually indistinguishable from that of a nation state.

The Maastricht Treaty provided the Union with the powers to achieve economic and monetary union. Chapter 1 of Title VIII TFEU concerns economic policy. It requires Member States to conduct their economic policies with a view to contributing to the achievement of the objectives of the Union[35] and in the context of the broad economic guidelines laid down annually by the Council.[36] Monetary policy is dealt with in Chapter 2 of Title VIII and applies to those countries which have satisfied the criteria for the single currency and have not opted out of the process. They are subject to the continuous duty of avoiding excessive government deficits[37] with the risk of being subject to a number of sanctions, including being fined. The economic crisis which started in 2008 has put a severe strain on the EMU and has cast serious doubt on the original Maastricht settlement. The crisis has shown that the EU has in fact a monetary union but not an economic union. The EU is only now trying to address this disequilibrium. These issues are considered in greater detail in Chapter 15.

The Lisbon Treaty shows the extent to which the EU is moving towards political union with the introduction of a Union minister for foreign affairs[38] as well as a president of the European Council,[39] together with expanding powers over matters such as police and judicial cooperation, areas which are no longer confined to the intergovernmental processes of the third pillar.[40] For Euro-zone Member States, much closer political union is now on the cards with proposals for EU control over national budgets and proposals for a further Treaty to deliver this.

D. UNDERSTANDING THE INTEGRATION PROCESS

Neo-functionalists argue that there is a spillover from one type of integration to another.[41] In other words, if states integrated one sector of their economies, usually an area of low

[34] Molle, see n. 11, 17. [35] Art. 120 TFEU. [36] Art. 121 TFEU.
[37] Art. 126 TFEU.
[38] Art. 18 TEU. The formal title is High Representative of the Union for Foreign Affairs and Security policy.
[39] Art. 15 TEU. [40] See Chapters IV and V of Title V TFEU.
[41] See the path-breaking work of E. Haas, *The Uniting of Europe: Political, social and economic forces 1950–1957* (Stanford, Calif.: Stanford University Press, 1958). Supplementing the technical logic of functional spillover, neo-functionalists added the idea of political spillover. This involved the build-up of political pressures by interest groups, trade unions, and other actors to encourage further integration, with the Commission acting as a catalyst for these pressures.

controversy (e.g., harmonization of technical standards), technical pressures would push them to integrate other sectors which are increasingly controversial (e.g., monetary and political union). The following example illustrates this point.

Cutting Edge manufactures a successful range of lawnmowers in the UK. It wishes to break into new markets to sell more of its lawnmowers, with resulting benefits in terms of economies of scale. However, in order to sell on these new markets Cutting Edge needs to have both the right to export its goods from the UK without restriction and the right to import its lawnmowers into the new markets without fiscal or non-fiscal barriers to trade. It also needs to be able to promote and sell its lawnmowers in the host states without restriction. The provisions of the EU Treaties—especially Article 30 TFEU on customs duties, Article 110 TFEU on taxation, and Articles 34–5 TFEU on freedom to import and export—provide these rights.

Yet, removing barriers is not sufficient. Cutting Edge soon discovers that the levels of noise emission from lawnmowers permitted in France is lower than that in the UK. It is lower still in Germany. For Cutting Edge to sell on these markets, it has to redesign its lawnmower for each market unless and until there is mutual recognition by each state of the standards prescribed by the other states or a single harmonized standard is enacted by the EU. In fact, the EU has now used its powers under Article 114 TFEU to enact a directive on 'the approximation of the laws of the Member States relating to the noise emission in the environment by equipment for use outdoors'.[42] However, Cutting Edge still needs a reliable and predictable application of these rules and an ability to enforce them in all Member States in which it wishes to trade.

Even with a harmonized standard, Cutting Edge is faced with the problem that currency fluctuations, often caused by governments using the exchange rate as a tool of economic policy, make it difficult for it to price its lawnmowers effectively. For Cutting Edge, a single currency and thus monetary union is the only solution. But for monetary union to work there needs to be centralized control of state expenditure. Thus monetary union creates strong pressure for economic union with economic and fiscal policy being regulated centrally for the whole area of the common market. As we have seen, for the Euro-zone countries, economic and monetary union has become a reality. This in turn creates pressure for a political union to ensure political accountability of the economic actors.

The example of Cutting Edge shows how the process of integration involves a gradual reduction in the power of national governments and a commensurate increase in the ability of the centre—i.e. the EU's supranational[43] institutions (the Commission and the Parliament)—to deal with sensitive, politically charged issues. It is the logic which lies at the heart of the so-called 'Monnet method'. For Jean Monnet, (neo-) functionalism meant the creation of a supranational regime or organization—i.e., one with joint or pooled authority (the High Authority and subsequently the Commission)—initially with power over the production of coal and steel, and subsequently over other economic sectors, thereby creating 'the first concrete foundations of the European Federation which is indispensable to

[42] EP and Council Dir. 2000/14/EC ([2000] OJ L162/1).

[43] R. Keohane and S. Hoffman ('Conclusions: Community politics and institutional choice' in W. Wallace (ed.), *The Dynamics of European Integration* (London: RIIA, 1990), 280 note that 'supranationality refers to a process of decision-making in which the participants refrain from unconditionally vetoing proposals and instead seek to attain agreement by means of compromises upgrading common interests'.

the maintenance of peace'.[44] However, his objective of creating a European federation was to be achieved by stealth, combining a mixture of *dirigisme* (removing existing tariff and non-tariff barriers) with market forces.[45]

Some commentators argue that the evolution of the EU from merely a coal and steel community to a major economic and monetary union in a period of less than 50 years, suggests that neo-functionalism is the best explanation for the integration process. However, others reject functionalism as an adequate explanation for what is actually occurring in the EU. For Moravcsik, in his theory of liberal intergovernmentalism,[46] the role of the European Council is central to understanding the integration process. He says that integration proceeds as far and as fast as the governments of the Member States allow. He argues that the Single European Act 1986 was the product of inter-state bargaining between the British, French, and German governments and that traditional tools of international statecraft, such as threats of exclusion and side payments, explained the final composition of the 1992 programme and the SEA 1986.[47]

Keohane and Hoffman try to reconcile these approaches. In their reformulation of neo-functionalism they recognize that successful intergovernmental bargaining is a prerequisite to any form of spillover.[48] They note that, without a turnaround in French economic policy in 1983, and the decision of the British government to accept Treaty amendments to institutionalize deregulation, no consensus could have been reached on a programme to dismantle barriers in Europe.[49] Thus, spillover does not occur in a vacuum: it requires positive action on the part of the Member States.

These theories focus on the activities of states, but there is much more to the dynamic of European integration than states. Take, for example, the period leading up to the SEA 1986. While the involvement of the European Council was crucial in securing agreement on the objective of attaining the single market, in particular by resolving the issue of British budgetary contributions at the Fontainebleau summit in June 1984,[50] other institutions played a key role, especially the Commission. It was responsible for the Internal Market White Paper which placed much emphasis on the principle of mutual recognition which had been developed by the Court.[51] Within the Commission certain key individuals played a decisive

[44] M. Holland, *European Community Integration* (London, Pinter Publishers, 1993), 7 and 8, citing J. Monnet, *Memoirs*, trans. R. Mayne (New York: Doubleday and Company, 1978), 298. For a strong endorsement of this view, see the Preamble to the ECSC Treaty 'to substitute for age-old rivalries the merging of their essential interests; to create by establishing an economic community, the basis for a broader and deeper community among people long divided by bloody conflicts'. See, further, W. Wallace, 'Introduction: The dynamics of European integration' in W. Wallace (ed.), *The Dynamics of European Integration* (London: RIIA, 1990).

[45] Holland, see n. 44, 13.

[46] A. Moravcsik, 'Negotiating the Single European Act: National interests and conventional statecraft in the European Community' (1991) 45 *International Organisation* 19.

[47] Considered by A. Young and H. Wallace, 'The single market' in H. Wallace, W. Wallace, and M. Pollack (eds.), *Policy-Making in the European Union*, 5th edn (Oxford: OUP, 2005), 100.

[48] R. Keohane and S. Hoffman, 'Conclusions: Community politics and institutional choice' in W. Wallace (ed.), *The Dynamics of European Integration* (London: RIIA, 1990), 287.

[49] R. Keohane and S. Hoffman, 'Conclusions: Community politics and institutional choice' in W. Wallace (ed.), *The Dynamics of European Integration* (London: RIIA, 1990), 286.

[50] As early as Jun. 1981 the European Council expressed its concern about the undermining of the single market: EC Bull. 6/81. A specific Internal Market Council was created in Jan. 1983.

[51] See further P. Craig, 'The evolution of the single market' in C. Barnard and J. Scott (eds.), *The Law of the Single European Market: Unpacking the premises* (Oxford: Hart Publishing, 2002); and R. Dehousse, *The European Court of Justice* (Basingstoke: Macmillan, 1998), 86–8.

role, in particular Lord Cockfield and Jacques Delors.[52] This convergence of events and actors provides a clear demonstration that 'institutions matter'.[53] This lies at the heart of *new institutionalism* which involves the study of formal and informal institutions, conventions, the norms and symbols embedded in them, policy instruments, and procedures.[54]

The emphasis so far on state actors risks overlooking the fact that private actors also play a key role. For example, in the period leading up to the SEA a coalition of business interests, especially the influential European Round Table of Industrialists (representatives from the largest European companies) strongly supported the renewed impetus to make the single market a reality.[55] Increasingly other actors, particularly those from civil society such as the social partners (management and labour), have been brought into the process of policy formation and implementation.[56] And, from the earliest days of the Union, individuals have been used to help make the common market a reality in their own states when the Court of Justice (quietly[57]) developed the fundamental principles of direct effect[58] and supremacy[59] of Union law.[60] In this way the Court has created an alliance between itself and individuals, thereby circumventing the Member States and the Union legislator. At the same time the Court of Justice has harnessed national courts into the process of enforcing EU law.

This brief description of actors and processes reflects the *multilevel* nature of the governance in the EU:[61] decision-making competencies are shared by actors at different levels rather than monopolized by governments. The multilevel governance model views political arenas as interconnected, with actors, both public and private, operating in both the national and supranational arenas creating transnational associations in the process.[62] In order to understand free movement, it is the multilevel governance model which perhaps has the most to tell us about policymaking and implementation in the EU. We return to this

[52] 'Much of the success of the 1992 programme depended on our relationship. Delors left me to get on with it. I fathered it, launched it and drove it to the point of success': Lord Cockfield, quoted in C. Grant, *Delors: Inside the house that Jacques built* (London: Nicholas Brealey Publishing, 1994), 68. On the importance of Jacques Delors, see H. Drake, 'Political leadership and European integration: The case of Jacques Delors' (1995) 18 *Western European Politics* 140; and D. Dinan, *Ever Closer Union: An introduction to European integration*, 3rd edn (Basingstoke: Macmillan, 2005).

[53] K. Armstrong and S. Bulmer, *The Governance of the Single European Market* (Manchester: Manchester University Press, 1998).

[54] K. Armstrong and S. Bulmer, *The Governance of the Single European Market* (Manchester: Manchester University Press, 1998), 52.

[55] K. Armstrong and S. Bulmer, *The Governance of the Single European Market* (Manchester: Manchester University Press, 1998). For details on the influence of big business, in particular the European Round Table, see K. Middlemas, *Orchestrating Europe: The informal politics of European Union 1973–1995* (London: Fontana Press, 1995), 138–9.

[56] This is considered further in Ch. 12.

[57] E. Stein, 'Lawyers, judges and the making of a transnational constitution' (1981) 75 *American Journal of International Law* 1: 'Tucked away in the fairyland Duchy of Luxembourg and blessed, until recently, with benign neglect by the powers that be and the mass media', the Court of Justice has 'fashioned a constitutional framework for a federal-type structure in Europe'.

[58] Case 26/62 *NV Algemene Transport—en Expeditie Onderneming van Gend & Loos* v. *Netherlands Inland Revenue Administration* [1963] ECR 1.

[59] Case 6/64 *Flaminio Costa* v. *ENEL* [1964] ECR 585. See also Decl. 17 of the Lisbon Treaty concerning primacy.

[60] See, generally, J. Weiler, 'The transformation of Europe' (1981) 100 *Yale LJ* 2403.

[61] L. Hooghe and G. Marks, *Multi–level governance and European integration* (Lanham, Md.: Rowman and Littlefield, 2001).

[62] L. Hooghe and G. Marks, *Multi–level governance and European integration* (Lanham, Md.: Rowman and Littlefield, 2001), 3–4.

theme in the final chapter of this book. We turn now to consider the principles which underpin the four freedoms, principles which the Court has played a key role in developing.

E. THE PRINCIPLES UNDERPINNING THE COMMON MARKET

According to the integration theory, there are two approaches to attaining a common market (1) the *decentralized* model, underpinned by the principles of non-discrimination, market access, and the concept of competitive federalism, and (2) the *centralized* model which concerns harmonization. The choice between these two models says much about the respective power of the centre (the 'federal' government) and the states. We begin by examining the decentralized model.

1. THE DECENTRALIZED MODEL

The essence of the decentralized model is that states retain the freedom to regulate matters as diverse as product standards, qualifications to practise, and employment law so long as those national rules do not interfere with key principles of 'federal' law. In the early days of the EU, the key principle was non-discrimination. In more recent years the Court has developed the more intrusive 'market access' or 'restrictions' test to remove barriers to free movement. We shall now examine these two different approaches.

1.1. Non-discrimination

The principle of non-discrimination on the grounds of nationality is the cornerstone of the four freedoms. It adopts a comparative approach, requiring out-of-state goods, persons, services, and capital to enjoy the same treatment as their in-state equivalents.[63] This model presupposes that domestic and imported goods, and national and migrant persons, services, and capital are similarly situated[64] and that they should be treated in the same way.[65] The advantage with the non-discrimination model is that it does not interfere with national regulatory autonomy. Member States remain free to regulate the way that goods are produced and services provided, on condition that their regulation applies equally to home and host state goods or persons. So, national rules which are genuinely non-discriminatory are lawful. However, if there is (unjustified) discrimination, Union law requires the discriminatory element of the national measure to be set aside, but the substance of the national rule remains intact. This can be seen in the following example.

Widgets are produced in the UK and Portugal. Each state regulates the standards governing the production of these goods. In Portugal, before widgets originating in the UK can be sold, they are required to satisfy higher standards than widgets produced in Portugal. Portugal is therefore directly discriminating against British goods. The application of the non-discrimination principle means that Portugal can continue to set quality standards

[63] See M. Poiares Maduro, *We the Court: The European Court of Justice and the European Economic Constitution* (Oxford: Hart Publishing, 1998).

[64] If the goods/persons are not similarly situated then different treatment is permitted: Case 15/83 *Denkavit Nederland BV* v. *Hoofdproduktschap voor Akkerbouwprodukten* [1984] ECR 2171.

[65] Cf. D. Wilsher, 'Does *Keck* discrimination make any sense? An assessment of the non-discrimination principle within the European single market' (2008) 33 *ELRev*. 3.

for widgets but that the widgets produced in the UK must be subject to the same treatment as those produced in Portugal. So, Portugal has the choice of either requiring all of the UK's widgets to meet the same (lower) standards as those required of Portuguese widgets, or requiring all widgets produced in Portugal to be made to the same (higher) standards required by Portugal for British widgets. This example shows that the non-discrimination model says nothing about the level at which the standards should be set, merely that the imported and domestic goods must be treated in the same way. The result is that the diversity of national rules is preserved.[66]

However, this narrow approach to the principle of equal treatment may itself lead to discrimination, as the widgets example shows. Widgets produced in the UK have already been manufactured according to standards laid down by the UK. In order to be admitted to the Portuguese market they must also satisfy Portuguese standards. In practice, the effect of extending the principle of equal treatment to the British goods is to impose an additional burden on goods originating in the UK. One way of analysing this situation is to say that the Portuguese rule is in fact discriminatory: the discrimination arises because it involves treating identically goods which are actually differently situated. Another way of viewing this situation—and the one favoured by the Court of Justice[67]—is that Portugal's rule is indirectly discriminatory (or indistinctly applicable[68]): on the face of the measure the rule applies to both domestic and imported goods but in fact disadvantages the imported goods because of the double burden they must satisfy. Therefore, Portugal's rule is unlawful, even though equally applicable, unless Portugal can justify it by pointing to a reason which should take precedence over the free movement of goods, such as the need to protect consumers or the environment.

1.2. Market Access

(a) Market access vs. Discrimination tests

While the discrimination test has a number of advantages, there are drawbacks too. First, the model is premised on the fact that migrants and nationals are similarly situated when, by definition, they are not. Even if this intellectual hurdle can be surmounted, the choice of comparator is not always obvious and may be determinative of the outcome.[69] Secondly, the effect of the non-discrimination model is to allow barriers to movement to remain because it permits the host state to impose its own rules on imported goods/migrants provided those rules apply equally to domestic goods/persons. For this reason, some advocate that a broader market access test

[66] N. Bernard, 'Discrimination and free movement in EC law' (1996) 45 *ICLQ* 82, 103.

[67] See Case 120/78 *Rewe Zentrale* v. *Bundesmonopolverwaltung für Branntwein ('Cassis de Dijon')* [1979] ECR 649 considered in detail in Ch. 4.

[68] This terminology is explored further in Ch. 8.

[69] See, e.g., Case 270/83 *Commission* v. *France (tax credits)* [1986] ECR 273. France granted tax credits to shareholders receiving dividends from a company with a registered office in France but not to those with only a branch or agency in France (and a registered office in another Member State). The Court said that because Art. 49 TFEU expressly left traders free to choose the appropriate legal form in which to pursue their activities in another Member State that freedom of choice could not be limited by discriminatory tax provisions (para. 22). The French rule therefore breached Art. 49 TFEU and could not be justified on the facts. Thus, in its application of the principle of non-discrimination, the Court required the French tax system to treat a branch or agency having no legal personality in the same way as a company registered in France. If, as Banks notes, the Court had selected the treatment of a branch or agency of a nationally based company as the appropriate comparator, the outcome might have been very different (K. Banks, 'The application of the fundamental freedoms to Member State tax measures: Guarding against protectionism or second-guessing national policy choices' (2008) 33 *ELRev*. 482, 488).

be applied. This provides that national rules preventing or hindering market access are unlawful, irrespective of whether they actually discriminate against imports or migrants. The market access approach therefore looks at the national rule solely from the perspective of the (usually out-of-state) claimants: does the national rule prevent or hinder their market access?

The Court of Justice increasingly favours the market access approach. For example, in *Gebhard*,[70] a case concerning national rules on the use of the title *avvocato* in Italy, the Court abandoned the language of discrimination and said that the national measures were 'liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty'. Such rules breached Article 49 TFEU on freedom of establishment unless they could be justified. In *Commission* v. *Italy (trailers)*,[71] a goods case, the Court said that 'Any other measure which hinders access of products originating in other Member States to the market of a Member State' breaches Article 34 TFEU. In subsequent case law, particularly in the field of persons and capital, the Court has tended to simplify the terminology and increasingly the reference to market access is replaced by the language of 'obstacles' to, or 'restrictions' on, free movement.[72]

While the discrimination and market access tests use different language, there is considerable overlap between the two models.[73] For example, quantitative restrictions for goods, refusal of entry/deportation of persons, and directly and indirectly discriminatory measures, by definition, hinder market access.[74] However, the difference between these two models can be seen when dealing with non-discriminatory rules, as the facts of *Commission* v. *Greece (opticians)*[75] illustrate. Greek law prohibited qualified opticians from operating more than one optician's shop. Under a pure discrimination model, this rule would be *lawful*: both Greek opticians and out-of state opticians are being treated equally (albeit equally badly). However, under the market access approach such a rule would be *unlawful* unless justified and this is the approach the Court adopted. It said this rule 'effectively amounts to a restriction on the freedom of establishment of natural persons within the meaning of Article [49 TFEU], notwithstanding the alleged absence of discrimination on grounds of nationality of the professionals concerned'.[76] This demonstrates the point already noted

[70] Case C–55/94 *Gebhard* v. *Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECR I–4165, para. 37, citing Case C–19/92 *Kraus* v. *Land Baden-Württemberg* [1993] ECR I–1663, para. 32; Case C–76/90 *Säger* v. *Dennemeyer & Co. Ltd* [1991] ECR I–4221, para. 12.

[71] Case C–110/05 *Commission* v. *Italy* [2009] ECR I–519, para. 50.

[72] Cf. J. Meulman and H. de Wael, 'A retreat from *Säger?* Servicing or fine-tuning the application of Article 49' (2006) 33 *LIEI* 207, 210–19.

[73] In Case C–341/05 *Laval un Partneri Ltd* v. *Svenska Byggnadsarbetareförbundet* [2007] ECR I–11767, para. 228 Mengozzi AG noted that it is often difficult to decide whether a set of rules adopted by private persons should be seen as indirect discrimination based on nationality, a restriction, a barrier or a deterrent to the freedom to provide services. See also S. Enchelmaier, 'The ECJ's recent case law on the free movement of goods: Movement in all sorts of directions' (2007) 26 *YEL* 115, 126–7.

[74] See, e.g., P. Van den Bossche, *The Law and Policy of the World Trade Organization: Text, cases and materials*, 2nd edn (Cambridge: CUP, 2008) who has one chapter entitled 'Principles of non-discrimination' and another entitled 'Rules on market access' which covers tariff barriers to trade (e.g., customs duties), non-tariff barriers (e.g., QRs, inspections, origin marking), and barriers to trade in services.

[75] Case C–140/03 *Commission* v. *Greece (opticians)* [2005] ECR I–3177.

[76] Para. 28. There is an argument that the Greek rule is indirectly discriminatory: there is a risk that it might operate to the particular detriment of out-of-state traders since they are more likely to want to establish a chain of opticians in Greece to justify the initial start-up costs. However, such arguments seem artificial (although this has not prevented the Court itself from relying on such artificiality: e.g., Case C–322/01 *Deutscher Apothekerverband eV* v. *0800 DocMorris NV* [2003] ECR I–14887, para. 74). A better analysis is that the rule should be regarded as non-discriminatory but that it still prevents or impedes market access.

that while the discrimination approach focuses on a comparison between the treatment of the in-state and out-of-state person/trader, the market access test focuses solely on the perspective of the out-of-state traders or migrants: what stands in their way of getting onto the market? Market access, at least in the early days, was a way of challenging over-regulation by states which makes cross-border trade difficult (just as it makes domestic trade difficult).[77] The question of nationality becomes irrelevant.

The advantage of the market access approach is that it goes a long way towards building a single market by removing any unjustified obstacles to trade. As Advocate General Jacobs noted in *Leclerc-Siplec*,[78] 'If an obstacle to trade exists it cannot cease to exist simply because an identical obstacle affects domestic trade.' The market access approach is based on the idea famously articulated in *Cassis de Dijon*[79] that goods lawfully produced in one Member State should presumptively have free and unrestricted access to the market in another Member State (the principle of equivalence or mutual recognition). This enables the trader to develop a pan-European strategy to expand the market for its goods, thereby creating greater economies of scale for the producer and greater choice and competition for the consumer. It is a win-win situation. Translating this to persons, those who are qualified to practise in one Member State should also, in principle, be free to practise in another Member State. Once again, this enables individuals to expand the market for their services or to move to a place where their skills are better rewarded/appreciated while offering greater choice to consumers in the receiving state.

The disadvantage with the market access approach is that it is far more intrusive into national regulatory autonomy since Union law requires the national measure to be struck down, unless it can be justified, even though it may not discriminate against the non-national.[80] This has serious implications for national legislation adopted by democratically elected governments, not least because a case can be made that almost any national rule has some effect on inter-state movement, even if that was never the intention of the rule and the effect on inter-state trade is slight.[81] Take, for example, a national law on the minimum wage. This could be challenged under the restrictions model because it would prevent migrants from working for less than the minimum and this might discourage them from moving to that state (the rule would not be open to challenge under the non-discrimination approach provided the minimum wage rate was the same for all workers, domestic and migrant). There is some evidence that in recent cases the Court has recognized the risk that the market access model is too all encompassing and so it has experimented with different legal techniques to draw the line between those rules which should be caught by Union law

[77] G. Davies, 'Services, citizenship and the country of origin principle', *Mitchell Working Paper Series* 2/2007, 3: As Davies puts it, 'There may be no identifiable inequality of effect, but there is a general suppression of economic activity.'

[78] Case C–412/93 *Leclerc-Siplec* v. *TF1 Publicité* [1995] ECR I–179.

[79] Case 120/78 *Rewe Zentrale* v. *Bundesmonopolverwaltung für Branntwein ('Cassis de Dijon')* [1979] ECR 649.

[80] This question is discussed further in C. Barnard, 'Restricting restrictions: Lessons for the EU from the US?' (2009) 68 *CLJ* 575.

[81] Cf., e.g., Case C–353/06 *Grunkin-Paul* [2008] ECR I–7639, paras. 23, 24, and 29 where the Court talked of the 'serious inconvenience' caused by a discrepancy in surnames which created an obstacle to free movement of citizens under Art. 21(1) TFEU. In Case C–110/05 *Commission* v. *Italy* (*Trailers)* [2009] ECR I–519 the Court referred to the '*considerable* influence' that a prohibition on the use of a product has on the behaviour of consumers.

and those which should be outside it. This is discussed in more detail in Chapters 5, 8, and 10 of this book.[82]

(b) The meaning of 'market access'

A further disadvantage with the market access test is the uncertainty which surrounds this 'inherently nebulous'[83] concept. Spaventa offers three possible interpretations.[84] The first, and narrowest, is that barriers to market access are those created by circumstances or legislation that make it 'more costly for new firms to enter an industry'.[85] There is some overlap between this approach and the discrimination model, especially if it is assumed, as the Court often does, that new market entrants come from out of state.[86] It is supported by *Commission* v. *Italy (motor insurance)*[87] where the Court said that an obligation on an insurance company to provide third-party insurance to cover any risks proposed to them and to moderate premium rates breached Articles 49 and 56 TFEU 'inasmuch as it involves changes and costs on such a scale that the obligation to contract renders access to the Italian market less attractive and, if they obtain access to that market, reduces the ability of the undertakings concerned to compete effectively, from the outset, against undertakings traditionally established in Italy'.[88]

The second, and much broader, approach to market access is that *any* regulation can be seen as a potential barrier to access, since *any* regulation imposes and implies compliance costs. This approach can be seen in the golden-share case, *Commission* v. *UK (British Airports Authority (BAA))*.[89] BAA's articles of association prevented any person from acquiring BAA shares carrying the right to more than 15 per cent of the equity in BAA. The Court said that 'Rules which limit the acquisition of shareholdings … constitute a restriction on the free movement of capital.'[90] The Court added that although the restrictions were non-discriminatory 'they affect the position of a person acquiring a shareholding as such and are thus liable to *deter* investors from other Member States from making such investments and, consequently, affect access to the market'.[91] The answer to the question 'What is the deterrence?' is presumably the very existence of the rule: had the rule not existed there would have been no breach.

The third approach is what Spaventa describes as 'intuitive': rules which interfere with intra-Union trade should be subject to judicial scrutiny while rules considered neutral as regards intra-Union trade should not. The intuitive approach can be seen in *Laval*.[92] The case concerned a Latvian company which won a contract to refurbish a school in Sweden using its own Latvian workers. It faced ruinous industrial action by the Swedish

[82] See the discussion of the *Keck* (Joined Cases C–267 and 268/91 [1993] ECR I–6097) line of case law in Ch. 5 and the *Viacom* (Case C–134/03 [2005] ECR I–1167) line of case law in Ch. 8 and Case C–518/06 *Commission* v. *Italy (motor insurance)* [2009] ECR I–3491 in Ch. 10.

[83] P. Oliver and S. Enchelmaier, 'Free movement of goods: Recent developments in the case law' (2007) 44 *CMLRev*. 649, 674.

[84] 'From *Gebhard* to *Carpenter*: Towards a (non-)economic European Constitution' (2004) 41 *CMLRev*. 743, 757–8. See also C. Barnard and S. Deakin, 'Market access and regulatory competition' in C. Barnard and J. Scott (eds.), *The Legal Foundations of the Single Market: Unpacking the Premises* (Oxford: Hart Publishing, 2002).

[85] Citing Folovary, *Dictionary of Free Market Economics* (Northampton: Edward Elgar Publishing Inc., 1998), 48.

[86] Case C–322/01 *DocMorris NV* [2003] ECR I–14887, para. 74.

[87] Case C–518/06 *Commission* v. *Italy (motor insurance)* [2009] ECR I–3491.

[88] Para. 70.

[89] Case C–98/01 *Commission* v. *UK* [2003] ECR I–4641.

[90] Para. 44.

[91] Para. 47, emphasis added. Cf. Case C–542/08 *Barth* v. *Bundesministerium für Wissenschaft und Forschung* [2010] ECR I–3189, para. 39.

[92] Case C–341/05 *Laval un Partneri Ltd* v. *Svenska Byggnadsarbetareförbundet* [2007] ECR I–11767.

trade unions when it refused to apply Swedish collectively agreed terms and conditions. Although this industrial action was permissible under Swedish law, Laval brought proceedings in the Swedish labour court, claiming that the industrial action was contrary to Article 56 TFEU. The Court said:

> the right of trade unions of a Member State to take collective action by which undertakings established in other Member States may be forced to sign the collective agreement for the building sector … is *liable to make it less attractive, or more difficult*, for such undertakings to carry out construction work in Sweden, and therefore constitutes a *restriction* on the freedom to provide services within the meaning of Article [56 TFEU].[93]

But how, precisely, did the collective action impose costs which made it 'more difficult' or 'less attractive' for Laval to operate in Sweden? Deakin suggests that one answer might be 'more difficult' in relation to the situation which would have prevailed had Latvian law and/or Latvian collective agreements applied.[94] If this is correct, it means that the effect of the restrictions analysis is to enable service providers to export their home country laws and have them applied extraterritorially. Another answer may be intuition: Laval was a Latvian company and it was having difficulty fulfilling a contract which it had legitimately won, largely due to its cheaper labour costs. The Swedish strike action therefore prevented it from doing the very thing that EU accession had promised to the new Member States, namely free access to the markets in services in other Member States; and that was enough to trigger Article 56 TFEU.

But if the effect of *Laval* is to allow challenges to host state rules which differ from those which apply at home, this suggests that a mere difference between the rules of two states is sufficient to constitute a restriction on free movement, an understanding that the Court has rejected in the past.[95] Following *Laval* there is no reason why German tourists might not argue that the requirement of having to drive on the left hinders their free movement since British rules are different to those in Germany. Here, the Court's 'intuition' might lead it to find that the rules are in fact neutral as regards intra-Union movement. This might explain why in *Burbaud*[96] the Court said that the requirement of passing an exam in order to take up a post in the public service could not 'in itself be regarded as an obstacle' to free movement.[97]

Despite the problems with the market access test, the Court continues to see it as the mainstay of its analysis, as demonstrated by two Grand Chamber decisions of 2009, *Commission* v. *Italy (trailers)*[98] and *Commission* v. *Italy (motor insurance)*.[99] In both these cases the Court endorsed the market access analysis and offered some guidance as to the meaning of the phrase. The *Trailers* case concerned an Italian prohibition on

[93] Para. 99, emphasis added.

[94] 'Regulatory competition after *Laval*' (2007–8) 10 *CYELS* 581, 585–7.

[95] Case C–177/94 *Criminal Proceedings against Gianfranco Perfili, civil party: Lloyd's of London* [1996] ECR I–161, para. 17; Case C–384/93 *Alpine Investments BV* v. *Minister van Financiën* [1995] ECR I–1141, para. 27.

[96] Case C–285/01 *Burbaud* v. *Ministère de l'Emploi et de la Solidarité* [2003] ECR I–8219.

[97] Para. 96. To emphasize the point, the Court said that inasmuch as all new jobs are subject to a recruitment procedure, the requirement of passing a recruitment competition could not 'in itself be liable to dissuade candidates who have already sat a similar competition in another Member State from exercising their right to freedom of movement as workers' (para. 97).

[98] Case C–110/05 [2009] ECR I–519.

[99] Case C–518/06 [2009] ECR I–3491.

motorbikes towing trailers. The Court indicated that market access could be hindered by a rule which has 'considerable influence on the behaviour of consumers, which, in its turn, affects the access of that product to the market of that Member State'.[100] Thus, (significant) reduction in demand is sufficient to satisfy the market access test. In the *Motor Insurance* case the Court said that the obligation of an insurance company to provide third-party cover to every potential customer constituted a 'substantial' interference in the operators' freedom to contract,[101] and that the obligation was likely to lead, in terms of organization and investment to 'significant additional costs for such undertakings'.[102]

For Snell, however, the notion of market access conceals rather than clarifies.[103] He argues that it covers a range of situations including discrimination against free movers or free movement,[104] substantial or direct obstacles to trade or free movement,[105] and substantial reductions in profitability.[106] He concludes 'As the term lacks a clear content, the Court may use it freely either to approve or to condemn measures that it happens to like or dislike. Market access may simply provide a sophisticated-sounding garb that conceals decisions based on intuition.'[107]

(c) Market access vs. Exercise

There is a further practical problem with the language of market access: it suggests that restrictions on initial access to the market (e.g., requiring individuals to have certain qualifications, linguistic skills, or a licence before they do a particular job) are more serious than restrictions imposed by the host state when the migrant has actually got on to the market but is trying to exercise his freedoms (e.g. rules restricting tax and social advantages).[108] Yet rules restricting exercise of a free movement right can have just as serious a consequence on free movement as the initial refusal of access.[109] This can be seen in *Steinhauser*,[110] where a German artist was permitted to work (access) but not to participate in a tendering process for the use of a boutique from which to sell his art works (exercise). The Court, rejecting the French argument that Article 49 TFEU applied only to conditions regulating *access*, said that 'The Treaty includes the right not only to take up activities as

[100] Para. 56. [101] Para. 66. [102] Para. 68.

[103] J. Snell, 'The notion of market access: A concept or a slogan?' (2010) 47 *CMLRev*. 437.

[104] See, e.g., Poiares Maduro AG in Case C–446/03 *Marks & Spencer* v. *Halsey* [2005] ECR I–10837, para. 37 where he said national policies 'must not result in less favourable treatment being accorded to transnational situations than to purely national situations'.

[105] Case C–518/06 *Commission* v. *Italy (Motor Insurance)* [2009] ECR I–3491.

[106] Cf. Case C–518/06 *Commission* v. *Italy (Motor Insurance)* [2009] ECR I–3491 with Joined Cases C–544/03 and C–545/03 *Mobistar SA* v. *Commune de Fleron* [2005] ECR I–7723.

[107] Some support for this view can be found in A. Rosas, '*Dassonville* and *Cassis de Dijon*' in M. Poiares Maduro and L. Azoulai, *The Past and Future of EU Law: The classics of EU Law revisited on the 50th anniversary of the Rome Treaty* (Oxford: Hart Publishing, 2009).

[108] This is the view of Lenz AG in Case C–415/93 *Bosman* [1995] ECR I–4921, paras. 203 and 205. Cf. Alber AG in Case C–176/96 *Lehtonen* [2000] ECR I–2681, para. 48; and Fennelly AG's attempts in Case C–190/98 *Graf* [2000] ECR I–493 to reconcile the two.

[109] For a discussion on whether rules restricting market access and those restricting exercise of the freedoms are most serious, cf. Lenz AG in Case C–415/93 *Bosman* [1995] ECR I–4921, paras. 203 and 205 with Alber AG in Case C–176/96 *Lehtonen* [2000] ECR I–2681, para. 48.

[110] Case 197/84 *Steinhauser* v. *City of Biarritz* [1985] ECR 1819.

a self-employed person but also to pursue those activities in the broadest sense, including renting business premises.' The effect of this decision is now enshrined in the Services Directive 2006/123:[111] the directive applies to 'requirements which affect access to *or* the exercise of a service activity'.[112]

Given that it is often difficult to distinguish market access situations from those concerning exercise, the Court increasingly says that the national rules are 'restrictions' or 'obstacles' to free movement rather than hindering market access. We saw this in *Laval*, and can see it again in the *Motor Insurance* case where the Court said 'the concept of restriction covers measures taken by a Member State which, although applicable without distinction, affect access to the market for undertakings from other Member States and thereby hinder intra-[Union] trade'.[113] In cases involving free movement of natural persons and citizens, the Court tends to abandon the (more commercial) market access language altogether, talking instead of how the national rule is liable to dissuade or deter an individual from exercising his right of free movement.[114]

(d) The convergence or unity thesis

One of the debates which has bedevilled the area of free movement is whether a single principle (e.g., non-discrimination or market access) should cover all four freedoms. The arguments in favour relate to the need for clarity, certainty, and consistency in interpretation,[115] particularly as an increasing number of cases raise issues affecting a number of freedoms (for example, a restriction on advertising might engage both Article 34 TFEU on goods and Article 56 TFEU on services[116]).

On the other hand, there are significant differences between the freedoms, in particular those provisions relating to the movement of natural persons, where human rights have a more significant role to play than when, for example, free movement of goods are at stake. Further, there are differences between the freedoms in respect of which state has particular responsibility for regulation; in respect of free movement of goods and services, the principal regulator is the home state so any requirements imposed by the host state must take into account the controls already imposed by the home state. By contrast, in respect of free movement of workers and freedom of establishment, the principal regulator is the host state which might suggest that there is more room for the host state to impose its requirements on the migrant.

[111] OJ [2006] L376/26.

[112] 9th Recital, emphasis added. See also Art. 49(2) TFEU 'Freedom of establishment shall include the right to *take up and pursue* activities as self employed persons' (emphasis added).

[113] Para. 64.

[114] See, e.g., Case C–499/06 *Nerkowska* [2008] ECR I–3993: '31. With regard to the scope of Article [21(1) TFEU], the Court has already held that the opportunities offered by the Treaty in relation to freedom of movement cannot be fully effective if a national of a Member State can be deterred from availing himself of them by obstacles raised to his residence in the host Member State by legislation of his State of origin penalising the fact that he has used them … 32. National legislation which places certain of the nationals of the Member State concerned at a disadvantage simply because they have exercised their freedom to move and to reside in another Member State is a restriction on the freedoms conferred by Article [21(1) TFEU] on every citizen of the Union.'

[115] A point recognized by Poiares Maduro AG in Joined Cases C–158/04 and C–159/04 *Alfa Vita Vassilopoulos AE* [2006] ECR I–8135, para. 33.

[116] See, e.g., Joined Cases C–34–36/95 *Konsumentombudsmannen (KO)* v. *De Agostini (Svenska) Förlag AB* and *TV-Shop i Sverige AB* [1997] ECR I–3843.

The shift to the market access/restrictions test in respect of all the freedoms does suggest an increasing degree of convergence; the differences between the freedoms manifest themselves in respect of the crafting of the justifications, the role of fundamental human rights, and the Court's approach to proportionality. However, in concentrating on market access rather than discrimination as the basic test for establishing whether there is a breach of the Treaty, the Court has subtly altered the balance of power between the Union and the Member States. While a non-discrimination approach creates a space in which national regulators are free to act, untrammelled by Union law, the market access test has shifted the balance back in favour of the Union, giving the Court the power to scrutinize an ever-wider category of national measures for their compatibility with Union law.

1.3. Competitive Federalism

Both the non-discrimination and market access tests are premised on a *decentralized* model to market-building: Member States retain the freedom to regulate provided that they do not overstep the limits laid down by the Treaty (non-discrimination/market access). The effect of the EU rules on free movement of goods, persons, services, and capital is to place the different national systems into competition because those individuals or companies not satisfied with the political/legal/social environment in which they find themselves are free to move to another Member State which has a regime which suits them better. This freedom for individuals/capital to move has the effect of forcing the national systems to compete to produce the best rules to attract (or retain) valuable assets (capital and labour). This is known as competitive federalism or regulatory competition.[117]

For competitive federalism to function, two conditions need to be satisfied. First, the *federal* (central) authorities must lay down and enforce the rules giving goods, persons, and capital freedom to exit one Member State and enter another. Secondly, the *states* (the decentralized authorities) must remain free to regulate the production of goods and the qualifications of people according to their own standards so as to enable regulators to respond to the competition. The outcome of this process of regulatory competition should be to produce optimal, efficient, and innovative legislation (a race to the top) because state officials vie with one another to create increasingly attractive economic circumstances for their citizens, knowing that re-election depends upon their success.[118] Regulatory competition also promotes diversity and experimentation in the search for effective legal solutions by providing for comparative data to assist in regulatory reform. This reduces the risk of widespread adoption of flawed laws. This is the classic 'laboratory of democracy' theory[119] which recognizes that competition is a dynamic process where trial and error is the best means of finding the optimal solution to complex problems.[120] Company law in the United States is

[117] This is based on Tiebout's famous 'pure theory' of fiscal federalism: C. Tiebout, 'A pure theory of local expenditure' (1956) 64/5 *Journal of Political Economy* 416. For further details see C. Barnard and S. Deakin, 'Market access and regulatory competition' in C. Barnard and J. Scott (eds.), at n. 52; and G. Wagner, 'The economics of harmonisation: The case of contract law' (2002) 39 *CMLRev*. 995.

[118] D. Tarullo, 'Federalism issues in the United States' in A. Castro, P. Méhaut, and J. Rubery (eds.), *International Integration and Labour Market Organisation* (London: Academic Press, 1992), 101.

[119] D. Tarullo, above n. 118, 101.

[120] R. Van den Bergh, 'The subsidiarity principle in European Community law: Some insights from law and economics' (1994) 1 *Maastricht Journal of European and Comparative Law* 337, citing F. A. von Hayek, 'Competition as a discovery process' in his *New Studies in Philosophy, Politics, Economics and the History of Ideas* (Chicago, Ill.: University of Chicago Press, 1978), 149.

often held up as an example of the success of regulatory competition. The American state of Delaware has been extremely successful in attracting companies to incorporate there,[121] and from this Delaware benefits from substantial incorporation fees. Some commentators attribute Delaware's success to its ability to offer the most suitable corporation laws[122] which other states have tried to emulate by revising their acts along similar lines.

The model of competitive federalism, with an active role for state authorities (in shaping their laws to meet the demands of consumers) and a limited role for the central authorities (ensuring freedom of movement) influenced the thinking of the drafters of the Treaty of Rome. The original EEC Treaty owed much to the ordo-liberal school which originated in Freiburg in the 1930s.[123] In simple terms, ordo-liberalists believed that the Constitution should protect economic freedoms (freedom of movement) from public (and private) intervention in the same way as it protects civil and political rights, and this would guarantee individual freedom.[124] Central to their idea was the concept of *Ordnungspolitik*, according to which individual government decisions should both flow from, and be constrained by, the principles embedded in an economic constitution.

However, some commentators say that the analogies between the EU Treaties and an economic constitution should not be pushed too far.[125] For example, Chalmers argues that ordo-liberalism assumes too rigid and too discrete a separation of the market from other policies.[126] Indeed, in the EU it is simply not possible to disentangle the four freedoms from social, consumer, health, and environmental policies. This is recognized in the TFEU itself which provides express grounds for Member States to derogate from individual rights for reasons connected with wider public interests such as public health and public policy. These derogations have been supplemented by an ever-expanding range of public-interest or 'mandatory' requirements developed by the Court. Together they reflect a 'social market' tradition whereby state intervention in the operation of the markets is accepted and expected, not only to address market failures but also to secure social values which are seen as public goods in their own right. Some of these ideas are now reflected in Article 3(3) TEU which identifies the establishment of a 'highly competitive social market economy' as one of the aims of the Union.[127]

[121] Over 40% of New York Stock Exchange-listed companies, and over 50% of Fortune 500 companies, are incorporated in Delaware. D. Charny, 'Competition among jurisdictions in formulating corporate law rules: An American perspective on the "race to the bottom" in the European Communities' (1991) 32 *Harvard International Law Journal* 422, 428.

[122] See, e.g., D. Charny, 'Competition among jurisdictions in formulating corporate law rules: An American perspective on the "race to the bottom" in the European Communities' (1991) 32 *Harvard International Law Journal* 422, 431–2; R. Romano, 'Law as a product: Some pieces of the incorporation puzzle' (1985) 1 *J.L.Econ & Org*. 225, 257–8. Romano explains the advantages offered by Delaware: it offers comprehensive statutes and case law; the continuity in and small size of Delaware's Courts of Chancery provide an experienced judiciary specialized in corporate matters; Delaware's large population of corporations quickly generates legal controversies and thereby new precedents and rules; Delaware's reliance on incorporation fees binds Delaware to maintaining the stability and serviceability of its system.

[123] D. Chalmers, 'The single market: From prima donna to journeyman' in J. Shaw and G. More (eds.), *New Legal Dynamics of European Union* (Oxford: OUP, 1995), 56.

[124] D. Gerber, 'Constitutionalizing the economy: German neo-liberalism, competition law and the "New Europe"' (1994) 42 *American Journal of Comparative Law* 25, 45–6.

[125] N. Reich, 'The November Revolution of the Court of Justice: *Keck*, *Meng* and *Audi* revisited' (1994) 31 *CMLRev*. 459.

[126] Chalmers, above n. 123, 66.

[127] Note also the possible downgrading of the objective of ensuring that competition is not distorted by its removal from the list of objectives in Art. 3 TEU and its inclusion in Protocol No. 27.

These derogations and public-interest requirements do, however, themselves create considerable barriers to trade which can be addressed only through centralized regulation, and the Treaty envisaged this too, by providing the EU with powers to harmonize conflicting national laws (initially Article 100 EEC (now Article 115 TFEU) on the establishment and functioning of the common market and Article 235 EEC (now Article 352 TFEU), the residual legal basis).

2. THE CENTRALIZED MODEL

The need to have centralized standards is largely premised on market failure. If regulatory competition worked effectively Member States would compete against each other for the best laws. In these circumstances the host state would not need to invoke the public-health derogation or the consumer protection mandatory requirement because the goods/services produced in the home state would already be of a very high standard. Yet, in order to ensure successful regulatory competition, certain conditions must be satisfied:[128] there must be full mobility of people and resources at little or no cost; migrants must have full knowledge of each jurisdiction's revenue and expenditure patterns; and there must be a wide choice of destination jurisdictions to enable citizens to make meaningful decisions about migration. In reality these conditions are never met. For individuals the chances of exit are slim because they are unlikely to leave their own jurisdiction for linguistic, cultural, financial, or personal reasons; and capital (direct investment in business operations) is unlikely to leave unless a variety of factors (market proximity, transport costs, infrastructure levels, labour costs, and productivity levels) justify the move. Even if these conditions could be met, state legislation is often insufficiently responsive to the needs of its consumers. This creates the risk that the type of regulatory competition which emerges is undesirable.

The following example demonstrates this. The UK knows that in practice individuals are less mobile than capital and so it decides to gain a competitive advantage in the single market by reducing employment protection or environmental standards in order to remain attractive to capital.[129] While such a strategy might have short-term benefits (e.g., job creation or at least job retention) it undermines the longer-term interests of the citizenry as a whole (e.g., lower quality jobs and an inferior environment). Faced with such deregulation by the UK, Portugal—which risks losing capital and thus jobs to the UK—relaxes its own standards. The UK responds by lowering its standards still further and a race to the bottom ensues with the UK and Portugal now competing on the basis of low standards.

Some commentators argue that this is the true explanation for what is actually happening in Delaware: its success in attracting incorporation is due to its victory not in a race to the top but in a race to the bottom. As Cary graphically puts it, Delaware, 'a pygmy among the 50 States prescribes, interprets, and indeed denigrates national corporate policy as an incentive to encourage incorporation within its borders, thereby increasing its revenue'.[130] While there is much controversy about the likelihood of EU states engaging in a full-blown race to the bottom,[131] there is a perception that it may happen and that steps need

[128] For the literature on the economics of federalism, see Tiebout, above n. 117; F. Easterbrook, 'Antitrust and the economics of federalism' (1983) 26 *Journal of Law and Economics* 23, 34.

[129] This point was expressly recognized by Poiares Maduro AG in Case C–438/05 *Viking* [2007] ECR I–10779, para. 70.

[130] W. Cary, 'Federalism and corporate law: Reflections upon Delaware' (1974) 83 *Yale Law Journal* 663, 701.

[131] C. Barnard, 'Social dumping revisited: Lessons from Delaware' (2000) 25 *ELRev*. 57.

to be taken by the central bodies to combat it. This is what Cary called for in the US—the enactment of a *Federal* Corporate Uniformity Act, allowing companies to incorporate in the jurisdiction of their own choosing but removing much of the incentive to organize in Delaware or its rival states.[132]

Centralization offers advantages in terms of economies of scale by establishing a single set of rules applying to a broad class of transactions. It also reduces the costs that stem from evasion, through forum shopping, externalization, and extraterritoriality.[133] On the other hand, it raises difficulties, both legal (e.g., does the central body have the power to act (competence), should it act (subsidiarity), and, if so, to what extent (proportionality)?), and practical (e.g., should the harmonized standard represent an arithmetical mean of existing national measures or the optimal solution?).[134] It also creates political problems: it does not leave room for national diversity (i.e., the result would be one centrally regulated standard for an EU sausage, replacing hundreds of different regional varieties of sausage); it loses the benefits associated with local accountability; and it may lead to 'market freezing', reducing legislative innovation and experimentation. It also assumes a developed system of enforcement capable of preventing more complex forms of evasion. These issues are considered in detail in Chapter 16.

F. CONCLUSIONS

The driving force behind the European Union is, and has always been, the consolidation of a post-war system of inter-state cooperation and integration that would make pan-European armed conflict inconceivable. This has been promoted through a vigorous emphasis on free trade, with all the economic benefits this entails, albeit not to the exclusion of all other interests. As we have seen, the TFEU allows Member States to derogate from the rules of free trade where overriding national interests are at stake.[135] It also makes provision for structural funds to help those who are losers in the integration process, in particular the European regional development fund and the European social fund.[136] And as the EU's self-perception changed from a European *Economic* Community to a European Union, so its tasks and objectives have been broadened to take into account a wider range of policies which may complement, but may also obstruct, free trade. For example, Article 3 TEU identifies a number of tasks for the Union which were not found in the original Treaty of Rome including full employment and social progress, equality between men and women, environmental protection, and combating social exclusion and discrimination. The solidarity between citizens of the EU envisaged by these measures and the state/federal

[132] Cary, above, n. 130, 701.

[133] J. Trachtman, 'International regulatory competition: Externalization and jurisdiction' (1993) 34 *Harvard Int. LJ* 47.

[134] A. Dashwood, 'Hastening slowly' in H. Wallace, W. Wallace, and C. Webb (eds.), *Policy Making in the European Community* (Chichester: Wiley, 1983), 178.

[135] See, e.g., Arts. 36, 45(3), and 52 TFEU considered in Chs. 6 and 13.

[136] Reg. 1083/2006 ([2006] OJ L210/25) laying down general provisions on the European Regional Development Fund, the European Social Fund, and the Cohesion Fund. See generally J. Scott, *Development Dilemmas in the European Community: Rethinking regional development policy* (Buckingham: Open University Press, 1995).

intervention they necessitate are a far cry from an ordo-liberal/neo-liberal agenda which underpinned the Treaty of Rome.

This change in orientation can be seen in the simple statement by the Court in *Deutsche Post*,[137] a case on Article 157 TFEU on equal pay. Originally, Article 157 TFEU was included in the EEC Treaty as a market-making measure. It was intended to stop French industry, which had to respect the principle of equal pay for men and women, from losing out to companies established in other states (such as Italy) where the principle of equal pay was not respected. This economic function of Article 157 TFEU was recognized by the Court in some of its earliest case law.[138] Yet by the time the Court decided *Deutsche Post* in 2000 the change in approach was clear. The Court said that 'the economic aim pursued by Article [157 TFEU] …, namely the elimination of distortions of competition between undertakings established in different Member States, is *secondary* to the social aim pursued by the same provision, which constitutes the expression of a fundamental human right'.[139] This is significant as it marks an important shift in emphasis—from a pure market-based, neo-liberal vision premised on deregulation, efficiency, and the assumption of formal equality between individuals—to one which recognizes the need to accommodate and indeed value a wider range of interests. This change is encapsulated by the reference introduced by the Lisbon Treaty in Article 3(3) TEU to a 'highly competitive *social market* economy'. This observation has already prompted Advocate General Cruz Villalón in *Santos Palhota* to suggest that the pre-Lisbon orthodoxy needs to be reconsidered.[140]

Since the 1970s the Court has tried to balance market rights with traditional civil, political, and social rights. This approach has now been legitimized by the adoption of the Charter of Fundamental Rights in 2000, now incorporated by reference into the Treaties.[141] This rights-based approach has increasingly shaped the contours of the Court's case law, particularly in the field of citizens' rights.[142] At a time when global movements are mobilizing forces against free trade which they see as both wasteful to sustainable resources and producing inequality (where the rich—both people and regions—do better out of free trade than the poor),[143] the EU would find itself significantly out of step with its citizens if it did not recognize broader social and environmental interests.[144] While this book focuses on the four freedoms, it also considers how the free-trade imperative is counterbalanced by these broader interests. It begins by considering the free movement of goods. Chapter 2

[137] Joined Cases C–270/97 and C–271/97 *Deutsche Post* v. *Sievers* [2000] ECR I–929.

[138] Case 43/75 *Defrenne* v. *Sabena II* [1976] ECR 455.

[139] Para. 57, emphasis added. See also Case C–438/05 *Viking* [2007] ECR I–10779, para. 79: 'Since the [Union] has thus not only an economic but also a social purpose, the rights under the provisions of the Treaty on the free movement of goods, persons, services and capital must be balanced against the objective pursued by social policy.'

[140] Case C–515/08 [2010] ECR I-9133, paras 51–53. See also the Monti Report, 'A new strategy for the simple market', 9 May 2010. See also C. Joerges and F. Rödi, 'The "Social Market Economy" as Europe's Social Model' EUI workup paper 2004/8.

[141] Art. 6(1) TEU.

[142] Case C–60/00 *Mary Carpenter* v. *Secretary of State for the Home Department* [2002] ECR I–6279; Case C–413/99 *Baumbast and R.* v. *Secretary of State for the Home Department* [2002] ECR I–7091.

[143] See further, e.g., E. Bircham and J. Charlton (eds.), *Anti–Capitalism: A guide to the movement* (London: Bookmarks Publications, 2001); Friends of the Earth, 'What's wrong with world trade?', <http://www.foe.co.uk/resource/briefings/wrong_with_world_trade.pdf>. For a more academic account, see H. Daly and J. Cobb, *For the Common Good: Redirecting the economy toward community, the environment, and a sustainable future*, 2nd edn (Boston, Mass.: Beacon Press, 1994).

[144] Case C-271/08 *Commission* v. *Germany (occupational pensions)* [2010] ECR I-7091; Case C-368/10 *Commission* v. *The Netherlands (Fair trade labels)* [2012] ECR (not yet published).

provides an introduction to the different Treaty provisions on goods and places them in the broader context of the WTO in which the EU must operate.

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