

# The internal market and the philosophies of market integration

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<b>1</b>	<b>Introduction</b>	310
<b>2</b>	<b>The nature of the internal market: three models</b>	311
<b>3</b>	<b>The nature of the internal market: the historical experience</b>	317
<b>4</b>	<b>The law of the internal market: the power to harmonize</b>	329
<b>5</b>	<b>The law of the internal market: the types of harmonization</b>	335
<b>6</b>	<b>Conclusion</b>	337
	<b>Further reading</b>	338

## **1 Introduction**

The building of a European market has been at the heart of the European integration project from the very beginning. In fact, ‘common market’ was for a long time used as a synonym for what is now the EU; when the British voted in a referendum on European Economic Community membership in 1975, they voted on whether they wanted to be a part of a ‘common market’. Today, market integration, and in particular the rules on the free movement of persons, was a major bone of contention in the Brexit referendum, and securing

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The main theme of the chapter is that the nature of the internal market is contested, lacks clarity, and has varied from time to time. This may at first glance appear surprising. After all, we have now had around 60 years to work out what the internal market means, and in fact the internal market is one of the very few concepts the Treaties actually define. According to Article 26(2) TFEU 'the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured'. Unfortunately, the definition is somewhat circular.<sup>1</sup> In order to understand it, we need to understand the free movement of goods, persons, and so on. Yet when we seek to explore the meaning of the four freedoms, we quickly discover that they need to be understood against the background of the internal market. In other words, to understand the internal market, the four freedoms have to be understood, and vice versa.

The present chapter begins by setting out three possible ways an internal market could be arranged. Those models are host country control, the harmonized model, and home country control. Each represents a very different approach to, or philosophy of, economic integration. They entail differing consequences for the division of power between the EU and its Member States, and between courts and legislatures. They are also likely to result in different balances being struck between economic and non-economic interests; in other words, one may benefit

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<sup>1</sup> See the chapter by S Weatherill in M Adams, J Meeusen, G Straetmans, and H de Waele (eds), *Judging Europe's Judges: The Legitimacy of the Case Law of the European Court of Justice Examined* (Oxford: Hart Publishing, 2013).

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The chapter continues by examining how the nature of European market integration has changed in the course of the history of the EU. It will argue that the original common market paradigm set out in the Spaak Report<sup>2</sup> and incorporated into the Treaty of Rome gradually gave way to the single market paradigm first initiated by the European Court of Justice and subsequently embraced by the political institutions. Further, it will be argued that we may now be moving towards yet another paradigm change, where the internal market is influenced by the need to create a true economic union. The contentious nature of market integration is illustrated by a case study exploring how it can both build support for the European project and undermine it.

Finally, in sections 4 and 5 the chapter moves to investigate the principal tool the Treaty has created for the achievement of the internal market, namely Article 114 TFEU. First, the extent of the power that this provision puts in the hands of the EU legislature is analysed, partly through the use of a case study. Secondly, the use of this power is explored, with focus on two techniques of approximation of the laws of the Member States: minimum and total harmonization.

A word of caution: the present chapter is only able to offer a partial picture of the internal market. To obtain a fuller view, the chapters on the four freedoms need to be consulted.<sup>3</sup> Here, I will seek to set out the broad context and to examine the power of the EU political institutions actively and positively to push for the creation or perfection of the internal market. Yet the ability of the Court to disapply national laws that violate the free movement

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<sup>2</sup> Report of the Heads of Delegation to the Foreign Ministers at the Messina Conference, 21 April 1956.

<sup>3</sup> Chapters 12, 13, 14, and 15.

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## 2 The nature of the internal market: three models

All markets need freedom. Suppliers of products and inputs need to be able to sell and buy. In the EU, the four freedoms of goods, services, persons, and capital provide this. However, all markets also need rules and the European internal market is no exception. Rules create the market in the first place: they establish property rights and contracts without which a market would not exist. They regulate what things can be sold and bought, and what things cannot.<sup>4</sup> Rules set out health and safety requirements that products must meet to be lawfully marketed, or qualifications that service providers must possess to trade legally. The fundamental question then is: who is to set the rules for the European internal market?

### 2.1 Three models of market integration

In theory, three different ideal models of organizing an internal market can be envisaged.<sup>5</sup> It is to be stressed that these are ideals; they help us to think about the issue, but do not exist in pure form anywhere. Each of the three models has different implications for the power structure of the EU, and for the balance between different interests.

The first possible model is *host country control*. This means that the rules of the country where the economic activity takes place apply. If a good is produced in country A but then

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<sup>4</sup> eg sale of human body parts.

<sup>5</sup> M Poiras Maduro, *We the Court* (Oxford: Hart Publishing, 1998), who uses the terms decentralized model, centralized model, and competitive model. KA Armstrong, 'Mutual Recognition' in C Barnard and J Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Oxford: Hart Publishing, 2002) employs the same terminology as the present chapter.

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sold in country B, it has to comply with the requirements of the latter State. If a worker from country C goes to work in country D, it is again the laws of the latter State that apply. Host State control is, of course, the normal situation when it comes to trade between independent countries. However, by committing to the internal market, the EU has decided to move further. This means that the host country control has to be tempered at least with a rule of non-discrimination. In other words, the rules of the host country apply, but those rules cannot discriminate against things or people from the other Member States.

The second possibility is a *harmonized model*. Here the conditions of a single unitary State are replicated at the EU level. For each issue, there is only one rule, which has been produced by the EU. All products and factors of production must comply with it, but can then be sold and bought freely in the territory of the entire Union.

The final model is *home country control*. This is the mirror image of host country control. The rule that applies to any given product or input is the rule of its country of origin, not the rule of the country where it is sold. For example, if a good is produced in country A and sold in country B, it is the rule of the first State that applies. If a worker from country C goes to country D, it is again the rules of the former State that regulate the activity. In other words, there is an EU rule of mutual recognition. For this kind of model to work, there has to be a significant level of trust between the countries.<sup>6</sup> Country B has to be confident that the goods produced in country A are safe. Country D has to trust that qualifications the worker obtained in country C render them competent to engage in the activity they are planning to undertake. In the real EU, such absolute trust does not exist. Instead, where mutual recognition does apply, it is tempered with exceptions that allow the host country to deny recognition in certain cases.

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<sup>6</sup> See eg K Nicolaïdis, 'Trusting the Poles? Constructing Europe through Mutual Recognition' (2007) 14

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## **2.2 The implications of the different models**

### **2.2.1 Consequences for sovereignty**

The three models outlined in the previous section have different implications for the sovereignty of Member States.<sup>7</sup> The model of *host country control* is likely to impose the fewest constraints on the autonomy of each State to regulate its own affairs, although much will depend on how the rule of non-discrimination is applied. The second, *harmonized model* entails a vertical transfer of power from the State level to the EU level. Member States lose their power to regulate their own affairs; instead the laws come from the EU. However, it needs to be remembered that Member States are well represented in the EU legislature; in particular they form the Council.<sup>8</sup> In other words, under the harmonized model the Member States to a degree are pooling their sovereignty: they exercise it jointly. The *home country control model* involves a reassignment of sovereignty between the Member States. Each State loses its power to control matters within its own territory in certain circumstances. At the same time, the rules of each country extend further than they did before and now apply to circumstances outside its borders.

### **2.2.2 Institutional consequences**

The different models also have different institutional consequences.<sup>9</sup> The balance between the power of the legislature and the power of the judiciary may be struck differently. In the *host country control model* the (national) legislatures are likely to play a dominant role, although

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<sup>7</sup> See generally eg J Snell, 'Who's Got the Power? Free Movement and Allocation of Competences in EC Law' (2003) 22 *Yearbook of European Law* 323.

<sup>8</sup> See further chapter 4.

<sup>9</sup> Snell, 'Who's Got the Power?' (n 7).

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In the *harmonized model* it can be expected that the (EU) legislature is the dominant player, but again this is not necessarily so. The natural way of creating a harmonized set of rules is that they are promulgated by the central legislature. However, the judiciary can also engage in harmonization, in two ways. It can create a deregulated, liberal, laissez-faire market by striking down rules in the name of the four freedoms.<sup>12</sup> Alternatively, it can be more selective and target national rules that differ markedly from a European consensus.<sup>13</sup> For example, if Member States A, B, and C have very similar laws, while the law of D is very

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<sup>10</sup> For definitions of direct and indirect discrimination, see chapter 13.

<sup>11</sup> For the classic account, see G Marengo, 'Pour une interpretation traditionnelle de la notion de mesure d'effet equivalent a une restriction quantitative' (1984) 19 *Cahiers de Droit Européen* 291.

<sup>12</sup> See N Bernard, 'The Future of European Economic Law in the Light of the Principle of Subsidiarity' (1996) 33 *Common Market Law Review* 633, 637.

<sup>13</sup> Poiars Maduro, *We the Court* (n 5) 72–76 calls this 'majoritarian activism'.

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In the third, *home country control model*, the role of the judiciary is likely to be pronounced. It will have to ensure that mutual recognition takes place. It may also have to set the reach of mutual recognition in two ways, if the legislature has not done so. First, which rules are subject to mutual recognition in the first place? For example, if a worker from country A moves to country B, his qualifications may be recognized. But what about the salary levels—are they also set by the legislation or collective agreements of the home country? Secondly, mutual recognition is typically subject to exceptions that allow the host country to insist on the application of its own rules,<sup>14</sup> for example in the name of public policy. For home country control to work, the use of these exceptions needs to be carefully monitored by a judicial institution.

### **2.2.3 Welfare considerations**

Each model obviously aims at improving the welfare of our societies, that is, making citizens better off. However, they do so in very different ways, with different consequences. The *host country control model* allows trade to take place, and basic economic theory tells us that this makes all participants wealthier.<sup>15</sup> It also allows for the protection of other interests. For example, the host country is free to set whatever environmental or consumer protection standards it sees fit, as long as it avoids discrimination. Different countries are able to

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<sup>14</sup> It is not a coincidence that in Case 120/78 *Rewe v Bundesmonopolverwaltung für Branntwein* ('*Cassis de Dijon*') [1979] ECR 649 the Court both insisted on mutual recognition and created additional justifications for Member States.

<sup>15</sup> See in the EU context, eg W Molle, *The Economics of European Integration: Theory, Practice, Policy* (5th edn, Aldershot: Ashgate, 2006).



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The *harmonized model* brings with it significant economic benefits, too, in particular in terms of economies of scale. There is only one rule that economic actors need to comply with, in contrast with the patchwork of national rules that host country control allows. This reduces various compliance and transaction costs, and may allow companies to produce more efficiently. Often, it is cheaper per unit to produce a large number of products than a small number. For example, a large factory with a long assembly line may be able to churn out goods more cheaply than a smaller enterprise. If there is only one product standard for a company to worry about, rather than a multitude of different standards, these economies of scale can be achieved. In practice, this is an argument that has often been put forward in Europe, and in particular it has been claimed that without unification European companies will struggle to compete against companies from countries with large home markets,<sup>16</sup> such as the US or China.

Under the harmonized model, other interests such as the environment can also be protected by appropriate rules being adopted at the EU level. However, there are at least three problems. By necessity, an EU-wide rule cannot take diversity into account: one rule has to fit all countries, even if their preferences vary. The more diverse the Member States are, the less likely it is that a compromise satisfying all can be found. Secondly, it can be doubted whether the EU legislature would in practice be capable of producing rules in sufficient quantity and quality to afford non-economic interests, such as the environment, appropriate

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<sup>16</sup> See eg P Cecchini et al, *The European Challenge 1992: The Benefits of a Single Market* (Aldershot: Wildwood House, 1988).

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The welfare implications of *home country control* are the most difficult to assess. This is because they introduce a complex element of regulatory competition into the mix.<sup>18</sup> Regulatory competition means that in addition to the competition between firms that all models of internal market entail there is also competition between legislatures. Each country will try to attract valuable assets, for example by creating policies designed to encourage inward investment and prevent capital flight. They supply policies in the same manner as companies supply products. Economic actors then choose among the offerings of the competing countries. For example, consumers in country A may buy products produced in, and according to the standards of, country B. They vote with their purse. This will benefit the producers based in country B, and will be a matter of concern for producers and the government of country A. It may be inclined to amend the rules of country A to make products coming from country A more attractive and to counteract the risk of capital flight. As another example, country C may wish to attract capital by imposing low taxes on corporate profits and creating a favourable regulatory climate. This may increase the flows of international inward investments to country C as investors vote with their feet, potentially forcing country D to reconsider its fiscal policies.

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<sup>17</sup> FW Scharpf, 'The Joint-Decision Trap: Lessons from German Federalism and European Integration' (1988) 66 *Public Administration* 239.

<sup>18</sup> See eg W Kerber, 'Interjurisdictional Competition within the European Union' (2000) 23 *Fordham International Law Journal* 217.

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Economists teach us that regulatory competition can have many beneficial effects.<sup>19</sup> First, it increases choice. A consumer can choose between products manufactured according to the specifications of many different jurisdictions. A worker can choose whether to live in a country of high salaries and relentless rat race, or lower income but good quality of life. Secondly, it creates a discovery mechanism.<sup>20</sup> Countries innovate to produce attractive rules and policies. They are tested in the marketplace for regulations. Some of these prove successful and are copied. Others fail to achieve the desired effect and are abandoned. This creates valuable information about which public policies actually work and which ones do not. In a way, each State acts as a laboratory of democracy.<sup>21</sup> Thirdly, regulatory competition may counteract the predatory tendencies of public officials. If they impose excessive taxes or oppressive rules, there is the option of exit. For example, an entrepreneur hit with a confiscatory tax may relocate to another jurisdiction to escape it. This possibility makes the imposition of such taxes less likely. Thus, regulatory competition may help to tame the leviathan.<sup>22</sup>

Unfortunately, regulatory competition can also prove detrimental.<sup>23</sup> This is uncontested in situations where the costs and the benefits of a policy fall on different jurisdictions. For

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<sup>19</sup> See already CM Tiebout, 'A Pure Theory of Local Expenditures' (1956) 64 *Journal of Political Economy* 416.

<sup>20</sup> This aspect of competition is emphasized in FA Hayek, 'Competition as a Discovery Procedure' (2002) 5 *Quarterly Journal of Austrian Economics* 9.

<sup>21</sup> The expression was coined by Justice Brandeis of the US Supreme Court in *New State Ice v Liebmann* 285 US 262 (1932).

<sup>22</sup> This is a prime concern of public choice theory. See eg G Brennan and JM Buchanan, *The Power to Tax: Analytic Foundations of a Fiscal Constitution* (Indianapolis, IN: Liberty Fund, 1980).

<sup>23</sup> See J-M Sun and J Pelkmans, 'Regulatory Competition in the Single Market' (1995) 33 *Journal of Common Market Studies* 67 for an attempt at cost-benefit analysis.

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example, assume that prevailing winds carry emissions from country A to country B. The government of country A would have no incentive to adopt appropriate environmental standards—after all, the benefits of the industrial activity fall on country A while the pollution falls on country B. In the language of economics, there are externalities, which render regulatory competition harmful. Further, it is sometimes supposed that regulatory competition leads more generally to an uncontrolled race to the bottom. The worry is that countries, in order to attract capital, will start competitively lowering their standards of labour or environmental protection (since people tend to be less mobile than capital) in a destructive cycle that leaves each with zero regulation. Emotive words such as social or environmental dumping are often used in this context. Whether a race to the bottom is a real danger associated with home country control is fiercely contested. There are arguments that such fears are unfounded or at least unlikely to materialize in practice. At any rate, empirical evidence is scarce.<sup>24</sup>

#### **2.2.4 Democratic concerns**

The previous paragraphs have considered the effects of different models of integration on the welfare of citizens as passive rule-takers. It is also important to consider the matter from the point of view of citizens as active rule-makers. In other words, do the different models have particular pitfalls from the perspective of democracy?

All three models have been subject to democratic criticism, from different perspectives. The argument against the *host country control model* has been that it is under-inclusive. Laws

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<sup>24</sup> See on a global scale, DW Drezner, *All Politics is Global: Explaining International Regulatory Regimes* (Princeton, NJ: Princeton University Press, 2007) who argues at 15 that: 'There are anecdotal examples that support the idea of a race to the bottom, but the bulk of the evidence strongly suggests that these assertions are flatly wrong.'

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are formulated by the citizens of the host State, or their representatives. They do not take into account the interests of outsiders, such as companies or workers of other Member States, who do not have a voice in the political process of the host country. Yet the laws also affect these outsiders. Thus, it is argued, the host country control model suffers from the weakness that some affected interests are not represented at all.<sup>25</sup> The *harmonized model* is vulnerable to the entire gamut of democratic deficit criticism that the EU is regularly subjected to.<sup>26</sup> This is covered elsewhere in this book.<sup>27</sup> The *home country control model* is open to criticism as well. A particular worry is that it distorts national democracy by favouring capital over workers.<sup>28</sup> Under home country control, actors have the option of exit. A factory owner who does not like the regulatory climate of country A can relocate their production facility to country B, or at least threaten to do so. The same exit option is also available for workers, in theory. In practice, the different factors of production, capital, and labour, have differing levels of mobility. Liquid capital can be sent to another jurisdiction at the press of a button, while human beings with family ties and fluent in their native language only will find the prospect of relocation daunting. Thus, the threat of capital flight tends to be more credible than the threat of loss of skilled workers, forcing national legislatures to pay particular heed

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<sup>25</sup> See eg C Joerges, 'What is Left of the European Economic Constitution? A Melancholic Eulogy' (2005) 30 *European Law Review* 461, 488.

<sup>26</sup> See for discussion, eg J Snell, 'European Constitutional Settlement, and Ever Closer Union, and the Treaty of Lisbon: Democracy or Relevance' (2008) 33 *European Law Review* 619.

<sup>27</sup> See esp chapters 2 and 4.

<sup>28</sup> M Kumm, 'Constitutionalising Subsidiarity in Integrated Markets: The Case of Tobacco Regulation in the European Union' (2006) 12 *European Law Journal* 503.

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Where does the discussion leave us? It shows that there are profoundly different philosophies of economic integration. The approaches have different consequences for fundamental features of our societies, such as distribution of power, institutional balance, welfare of citizens, and democracy. The creation of the internal market is not a value-neutral technical project that can be left to the experts to manage, but must be an object of wider debate and contestation. The next section will show that, as the theory predicts, in the real world the nature of the internal market has been fought over. It has not remained stable, but has fluctuated and continues to fluctuate, displaying features of all three models that have been outlined previously.

### **3 The nature of the internal market: the historical experience**

This section explores the evolution of the internal market of the EU.<sup>30</sup> It argues that there have been different paradigms of market integration. The initial paradigm was the common market. As envisaged in the Spaak Report that prepared the ground for the Treaty of Rome and in the early years of integration, the European marketplace would combine freedom and fairness, and would largely be achieved by the legislative activity of the EU. The planned common market had some affinities with the harmonized model discussed earlier. The

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<sup>29</sup> J Vella, *Nominal vs. Effective Corporate Tax Rates Applied by MNEs and an Overview of Aggressive Tax Planning Tools, Instruments and Methods* (IP/A/TAXE/2015-07, PE 563.450) finds at 12-14 a decline in effective corporate tax rates between 1999 - 2015.

<sup>30</sup> See also P Craig, 'The Evolution of the Single Market' in Barnard and Scott, *The Law of the Single European Market* (n 5); M Egan, 'Single Market' in E Jones, A Menon, and S Weatherill (eds), *The Oxford Handbook of the European Union* (Oxford: Oxford University Press, 2012); and LW Gormley, 'The Internal Market: History and Evolution' in N Nic Shuibhne (ed), *Regulating the Internal Market* (Cheltenham: Edward Elgar, 2006).

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common market paradigm was replaced by the single market paradigm in the course of the 1970s and 1980s. Under this paradigm, the European Court of Justice became a more important actor, and the substance of the law shifted towards a more competitive model where home country control had a larger role to play. However, it will be argued, the single market paradigm suffered from instability and weaknesses. Instead, a new economic union paradigm may be emerging. Finally, a case study will explore how the European Commission has sought to use the internal market to bolster the legitimacy of the EU, while the Brexit referendum demonstrated that it can also foster discontent.

A note about terminology: the original Treaty of Rome used the term common market. The Single European Act of 1986 inserted the term internal market, which coexisted with common market in the language of the Treaty. In the political discussions, the term single market was often preferred. The Lisbon Treaty, which came into force in 2009, replaced all references to the common market with internal market. The Court has tended to use all three concepts interchangeably. For example, in *Gaston Schul* it stated that the common market 'involves the elimination of all obstacles to intra-Community trade in order to merge the national markets into a single market bringing about conditions as close as possible to those of a genuine internal market.'<sup>31</sup> However, legal scholars have insisted that the common market and the internal market were different concepts.<sup>32</sup>

### **3.1 The common market**

The common market was at the heart of the Treaty of Rome of 1957 that established the European Economic Community. The EEC was a response to the failure of a more ambitious

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<sup>31</sup> Case 15/81 *Gaston Schul* [1982] ECR 1409, para 33.

<sup>32</sup> See eg LW Gormley, 'Competition and Free Movement: Is the Internal Market the Same as a Common Market?' [2002] *European Business Law Review* 517.

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The Spaak Report argued for the merger of separate national markets into a common market to arrest and to reverse the perceived international decline of Europe. The key benefits were thought to be the increasing division of work that would lead to efficiencies, achievement of economies of scale, and greater competition. Three sets of actions were proposed. First, national protections creating obstacles to trade had to be suppressed. This involved the abolition of customs duties and quotas as well as those national regulations that resulted in the practical elimination or control of foreign competition. At the same time, however, it was recognized that common European-level regulations would be needed in the

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<sup>33</sup> For an excellent short summary of the developments, see D Dinian, *Europe Recast: A History of European Union* (Basingstoke: Palgrave Macmillan, 2004).

<sup>34</sup> Dinian, *Europe Recast: A History of European Union* (n 32), quoting J Lacouture, *Pierre Mendès-France* (New York: Holmes and Meier, 1984).

<sup>35</sup> See n 2.

<sup>36</sup> P-H Laurent, 'Paul-Henri Spaak and the Diplomatic Origins of the Common Market, 1955–1956' (1970) 85 *Political Science Quarterly* 373.



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The EEC Treaty followed closely the blueprint set up by the Spaak Report. For goods, there were rules on elimination of customs duties and quotas, and also a new provision outlawing measures of equivalent effect that apparently followed from a query by a mid-ranking customs official.<sup>37</sup> For persons and services, tools and a process for liberalization were established. There were to be issue- or sector-specific initiatives, with the Commission proposing and the Council adopting common rules that would realize free movement. For capital, a more modest degree of liberalization was envisaged, again following legislative initiatives. A harmonization mechanism was also created for the purposes of eliminating distortions of competition, and the Commission was charged with applying competition law and policing State aids. There was some coordination of economic policies, and the European Social Fund and the European Investment Bank were established to shelter the workforce, to help underdeveloped regions, and to assist business modernization. Following French concerns that its higher social costs would undermine French companies, social provisions were included declaring, inter alia, the need to improve and harmonize working conditions

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<sup>37</sup> A Prate, *Quelle Europe?* (Paris: Commentaire Julliard, 1991) 55 and A Moravcsik, *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht* (London: UCL Press, 1999) 146.

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The common market was a carefully calibrated mix of freedom and fairness. On paper, it had affinities with the harmonized model discussed in section 2.1. Markets would be opened, but in a controlled fashion. There would be no creative destruction, but instead a managed process of adjustment, adaptation, and fair competition. All the key concerns of France were addressed. This proved a recipe for political success. The Treaty sailed through the French Parliament just three years after the death of the European Defence and Political Communities.

The early years of market integration proceeded successfully. Customs duties and quotas were indeed eliminated. However, the harmonization of national rules did not proceed as planned. The empty chair crisis and Luxembourg Accords of the mid-1960s had replaced the planned majority voting rules in the Council with the requirement of unanimity.<sup>38</sup> This made it difficult to engage in successful harmonization. Further, the task of creating a common market was probably greater than had been anticipated. Even for goods, non-tariff barriers proved prevalent. In the words of one observer, 'the lowering of tariffs has, in effect, been like draining a swamp. The lower water level has revealed all the snags and stumps of non-tariff barriers that still have to be cleared away.'<sup>39</sup> Further, technical and other developments

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<sup>38</sup> See eg J Gillingham, *European Integration 1950–2003: Superstate or New Market Economy?* (Cambridge: Cambridge University Press, 2003) 68–72.

<sup>39</sup> R Baldwin, *Non-Tariff Distortions of International Trade* (Washington DC: Brookings Institution, 1970), quoted in MP Egan, *Constructing a European Market: Standards, Regulation, and Governance* (Oxford: Oxford University Press, 2001) 41.

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### 3.2 The single market

The paradigm began to change in the 1970s.<sup>41</sup> The European Court of Justice stepped forward to take the lead. In the early 1970s, it found in a series of cases that the four freedoms, with the exception of capital, were directly effective. They could be applied even in the absence of the legislative activity that the Treaty had envisaged.<sup>42</sup> Starting in the late 1970s, it reinforced this by creating the principle of mutual recognition.<sup>43</sup> The Treaty freedoms went beyond simple non-discrimination rules and also required that the host country accepts goods, services, or economic actors that fulfil the requirements of the home country on its markets, unless the host State has a good reason to oppose such market access and does so in a proportionate fashion. In other words, the principle is that a product good enough for, say, French consumers, is also good enough for, say, German consumers, unless Germany can convincingly show otherwise. To use the language of section 2.1, the Court moved the

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<sup>40</sup> In the recent years, this has affected in particular the EU's attempts to come to grips with the digital revolution and has resulted in numerous legislative initiatives; see D Adamski, 'Lost on the Digital Platform: Europe's Travails with the Digital Single Market' (2018) 55 *Common Market Law Review* 719 for an overview.

<sup>41</sup> See also AJ Menéndez, 'The Existential Crisis of the European Union' (2013) 14 *German Law Journal* 453 at 471–484.

<sup>42</sup> See eg PP Craig, 'Once upon a Time in the West: Direct Effect and the Federalization of EEC Law' (1992) 12 *Oxford Journal of Legal Studies* 453, 463–467.

<sup>43</sup> Case 120/78 *Rewe v Bundesmonopolverwaltung für Branntwein* [1979] ECR 649. See further chapter 12.

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The Commission sought to capitalize on the rulings of the Court. It issued a Communication setting out a far-reaching interpretation of the principle of mutual recognition.<sup>46</sup> The initial reaction of the Member States was hostile. However, over time they became more receptive.<sup>47</sup> A national experiment at socialism had failed in France, and the French government moved from autarkic policies to support internal market liberalization. The Britain of Margaret Thatcher was pushing forward a programme of liberalization, and the Christian Democrats had replaced the Social Democrats in government in Germany. European businesses were lobbying hard for more economic integration to strengthen their

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<sup>44</sup> See W-H Roth, 'Mutual Recognition' and A Saydé, 'Freedom as a Source of Constraint: Expanding Market Discipline through Free Movement', both in P Koutrakos and J Snell (eds), *Research Handbook on the Law of the EU's Internal Market* (Cheltenham: Edward Elgar, 2017) on mutual recognition and on its relationship to national treatment.

<sup>45</sup> See, on the role of the Court, T Horsley, 'Institutional Dynamics Reloaded: The Court of Justice and the Development of the EU Internal Market' in Koutrakos and Snell (eds), *Research Handbook on the Law of the EU's Internal Market* (n 44).

<sup>46</sup> Communication from the Commission concerning the consequences of the judgment given by the Court of Justice on 20 February 1979 in Case 120/78 ('Cassis de Dijon') (OJ [1980] C256/2). See KJ Alter and S Meunier-Aitsahalia, 'Judicial Politics in the European Community: European Integration and the Pathbreaking *Cassis de Dijon* Decision' (1994) 26 *Comparative Political Studies* 535.

<sup>47</sup> See A Moravcsik, 'Negotiating the Single European Act: National Interests and Conventional Statecraft in the European Community' (1991) 45 *International Organization* 19 and W Sandholtz and J Zysman, '1992: Recasting the European Bargain' (1989) 42 *World Politics* 95 for classic studies of the impetus behind the single market project.

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The most visible element of the single market was the adoption of a new Treaty to amend the Treaty of Rome, the Single European Act (SEA), which followed an important Commission White Paper on the completion of the internal market<sup>49</sup> and entered into force in 1987. This document set out the aim of achieving the internal market by the end of 1992. The internal market was defined as 'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured'. For this aim to be realized, the SEA brought forward a new rule that allowed internal market legislation to be passed by qualified majority voting, rather than by unanimity. The SEA was supported by innovations in the Commission's approach to harmonization. Under the so-called 'new approach', harmonization would be focused on those national rules that survived the direct application of the Treaty. In other words, if the host country had to recognize the product of the home country under the four freedoms anyway, there was no need for the EU to legislate. Only if the host country was able to oppose the importation, for example on grounds of health and safety, was there a need for the EU legislature to engage. Further, the type of legislation would be different. Instead of detailed harmonization of rules on narrow sectors, broader directives would be adopted that would seek to harmonize only the essential health, safety, environmental, and other requirements. The details would be left for the European

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<sup>48</sup> According to K Nicolaïdes, 'Kir Forever? The Journey of a Political Scientist in the Landscape of Recognition' in M Poiars Maduro and L Azoulai (eds), *The Past and Future of EU Law: The Classics of EU Law Revisited on the 50th Anniversary of the Rome Treaty* (Oxford: Hart Publishing, 2010) 448: 'When I recently asked Lord Cockfield, Commissioner for the internal market, what he considered the greatest achievement of his career, he answered without a beat: to have exported Cassis from the European Court of Justice and goods to the single market Europe 1992 programme.'

<sup>49</sup> Commission White Paper, 'Completing the internal market', COM(85) 310 final.

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The single market paradigm had a number of advantages. It aligned the Treaty, harmonization, and standardization. It abandoned unachievable ambitions for complete harmonization. It left room for experimentation and local differences. Most importantly, it was realistic. The measures that needed to be adopted were by and large passed; the deadline of 1992 was for the most part met. The single market was created in a workable form. Importantly, this does not mean that the project was finished in 1992. New challenges arise all the time: for example, the digital transformation of the economy has engendered a need to develop rules for issues that were not on the radar in the early 1990s. In this sense, the single market will never be completed but will always be work in progress.

However, the success of the single market was a qualified one and the paradigm was never fully stable. When things such as convergence in labour productivity, wage dispersion, or trade within countries as opposed to between countries are measured, the European market does not appear well integrated.<sup>51</sup> In the same way, most predictions of the long term economic effects of Brexit forecast substantially reduced growth for the UK due to the loss of

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<sup>50</sup> See J Pelkmans, 'The New Approach to Technical Harmonization and Standardization' (1987) 25 *Journal of Common Market Studies* 249.

<sup>51</sup> See eg Europe Economics, 'Optimal integration in the single market: A synoptic review' April 2013, A Europe Economics report for BIS and C Pacchioli, 'Is the EU internal market suffering from an integration deficit? Estimating the "home-bias effect" ' (2011) CEPS Working Document 348. See V Aussilloux et al, *Making the Best of the European Single Market* (Bruegel, 2017) for possible remedies.

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Despite its theoretical attractiveness, the single market paradigm did not really satisfy many of the key stakeholders. First, from the business perspective the approach was less than perfect. While mutual recognition was fine in theory, in practice its application left a lot to be desired. National authorities were still left as guardians of market access, and could deny mutual recognition on the basis of the derogations written in the Treaty, such as the needs of public policy, or on the basis of exceptions developed in the case law, such as consumer or environmental protection. In other words, an attempt by a company to penetrate the market of another country was often frustrated by the insistence of host State officials that local rules be obeyed because the rules of the home country did not in their view sufficiently protect non-economic interests. Whether such a requirement was lawful depended on the proportionality of the host country rule. This was very difficult to predict in advance and could only be tested

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<sup>52</sup> G Tetlow and A Stojanovic, *Understanding the economic impact of Brexit* (Institute for Government, 2018), 23.

<sup>53</sup> See eg Commission Staff Working Paper, 'Extended impact assessment of the proposal for a directive on services in the internal market' SEC(2004) 21.

<sup>54</sup> See Commission Communication, 'A Blueprint for a Deep and Genuine Economic and Monetary Union: Launching a European Debate' COM(2012) 777 final.

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For national governments, the single market model created at least two types of difficulty. The national publics expect States to protect them from environmental degradation, substandard products, and so on. If there is a problem, for example a food scandal, the national government may get blamed. Yet those governments have now given up their ability fully to control products that are sold in their country. They might end up bearing the responsibility for things that they cannot affect. Further, the kind of competition the single market model entails may be branded unfair. National companies on the losing end might blame their lack of success on the various 'unfair' regulatory advantages that foreign competitors enjoy, such as lower standards or wages, and demand protection. Under European law such protection is likely to be illegal. This could leave the national decision-makers between the rock of domestic public opinion that expects the government to protect local companies and the hard place of EU rules that outlaw it.

For organized interest groups, such as trade unions or environmental groups, the principle of mutual recognition at the heart of the single market represented a threat. As discussed in section 2.2, the principle potentially allows regulatory competition to take place. This could undermine the labour or environmental standards that the groups were committed to. Even if fierce regulatory competition failed to start, the balance of power between organized interest groups and industry was altered. The industry was provided with the ability to threaten relocation in the absence of domestic reforms. In other words, the industry could tell the

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<sup>55</sup> J Pelkmans, 'Mutual Recognition in Goods: On Promises and Disillusions' (2007) 14 *Journal of European Public Policy* 699, 708–711. The EU has put forward various initiatives to improve the functioning of mutual recognition, in particular European Parliament and Council Regulation (EU) 2019/515 on the mutual recognition of goods lawfully marketed in another Member State (OJ [2019] L91/1).



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For the advocates of further integration, the single market was insufficient. It was a construct of logic and economic advantage. It lacked emotional pull; it did not instill Europatriotism in citizens. In the words of Jacques Delors, the President of the Commission during the single market project, 'It is difficult to fall in love with the single market.' In fact, quite the opposite: some of the most bitter resistance the European project has encountered has been due to attempts to extend the single market.

In this context, the enlargement of the Union is a significant factor. The expansions of 2004 and thereafter brought into the EU a large number of countries that were at quite a different level of economic development from the existing Member States. This created political problems. An attempt to enhance the effectiveness of the single market in the services sector by the adoption of a directive with a country-of-origin principle met fierce resistance, and resulted in the watering down of the directive. Judgments of the Court of Justice on the kinds of actions trade unions could take to oppose competition from the new Member States<sup>57</sup> entered into political discussion, for example in the context of the Irish referenda on the Lisbon Treaty, just as the threat of Polish plumbers 'stealing' the jobs of French plumbers had been invoked in debates on the Constitutional Treaty in France. In the UK, the resistance to the free movement of workers from Eastern Europe is thought to have been one of the key factors behind the Leave vote, as explored in Case study 11.1. Behind these phenomena was the economic insecurity that heightened competition created, in particular when the labour-cost differences between some of the new and old Member States

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<sup>56</sup> See generally C Barnard, 'Social Dumping and the Race to the Bottom: Some Lessons for the European Union from Delaware?' (2000) 25 *European Law Review* 57.

<sup>57</sup> See further chapters 13 and 20.

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The pressures described previously have had an impact on legal developments. As mentioned, the attempt to liberalize services markets in one fell swoop using the country-of-origin principle was abandoned.<sup>59</sup> The Commission has in certain areas moved away from the idea of divergent but coordinated national systems and instead returned to an approach based on more complete harmonization of rules.<sup>60</sup> The Commission has also contributed to uniformity at the level of implementation by working quietly to shift away from directives that need to be transposed by Member States to regulations that do not.<sup>61</sup> There have been attempts to emphasize social Europe and non-economic issues to appease disgruntled citizens, rather than leaving the matters for regulatory competition. This was expressed forcefully in the report for the Commission on the relaunch of the single market by Professor Monti. He advocated the creation of a stronger single market but also noted the need to build consensus to support it as 'today the single market ... is seen by many Europeans ... with

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<sup>58</sup> For an empirical assessment, see J Delhey, 'Do Enlargements Make the European Union Less Cohesive? An Analysis of Mutual Trust between EU Nationalities' (2007) 45 *Journal of Common Market Studies* 253. For details of the cases referred to here, see chapter 13.

<sup>59</sup> K Nicolaïdis and SK Schmidt, 'Mutual Recognition "On Trial": The Long Road to Services Liberalization' (2007) 14 *Journal of European Public Policy* 717.

<sup>60</sup> European Commission Green Paper on the Review of the Consumer Acquis, COM(2006) 744 final. See generally S Weatherill, 'Maximum versus Minimum Harmonization: Choosing between Unity and Diversity in the Search for the Soul of the Internal Market' in N Nic Shuibhne and LW Gormley (eds), *From Single Market to Economic Union: Essays in Memory of John A Usher* (Oxford: Oxford University Press, 2012).

<sup>61</sup> According to Internal Market Scoreboards, as of December 2018, there were 1,014 single market directives and 4,527 regulations in force. This contrasts with 1,490 directives and only 275 regulations in 2001. See J Pelkmans and A Correia de Brito, *Enforcement in the EU Single Market* (Brussels: CEPS, 2012) 107.

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Treaty, which commits the EU to the goal of a 'social market economy' and, in a gesture full of symbolism, relegates the EU's commitment to undistorted competition from the first articles of the Treaty to a Protocol. The Commission identified an internal market that is not only deeper but also 'fairer' as one of its priorities.<sup>63</sup> In other words, some of the single market paradigm's basic features have been checked or challenged.

### **3.3 Economic union?**

It is possible that we are now witnessing another paradigm shift for the internal market. The weakened, unstable single market paradigm may be giving way to an economic union paradigm. The proximate cause for this is the need to ensure the success of the single currency, the euro, which has been battered by the financial crisis that began in 2007. The departure of the UK may contribute to the developments, as the interests of the euro area and the interests of the EU as a whole may increasingly be seen to coincide.

The internal market and the economic and monetary union (EMU) complement each other, as was already recognized in the Commission's slogan 'one market, one money'. In fact, a single currency only makes sense in the context of an internal market. A decision to adopt a single currency is always an exercise in balancing its benefits against its costs,<sup>64</sup> and a well-functioning internal market increases the former and reduces the latter.

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<sup>62</sup> M Monti, 'A New Strategy for the Single Market: At the Service of Europe's Economy and Society', May 2010.

<sup>63</sup> J-C Juncker, 'A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change', available at [https://ec.europa.eu/commission/publications/president-junckers-political-guidelines\\_en](https://ec.europa.eu/commission/publications/president-junckers-political-guidelines_en).

<sup>64</sup> P Krugman, 'Revenge of the Optimum Currency Area' (2012) 27 *NBER Macroeconomics Annual* 439.

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At least four points need to be made. First, the advantages of a single currency in terms of lower transaction costs, greater transparency, and the elimination of exchange-rate risk are only felt if there is trade and investment, and a single currency can in turn be expected to provide a further boost for them. A strong internal market increases the benefits of the single currency, which in turn strengthens the internal market.

Second, the problem with a single currency is that it reduces flexibility: an individual Member State can no longer respond to economic developments by changing interest rates or the value of its currency. However, a well-functioning internal market may reduce the need for independent action by Member States if it brings with it an alignment of business cycles.<sup>65</sup> If every Member State experiences booms and busts simultaneously, a centralized monetary policy will work well—there is simply less need for national autonomy.

Third, in the literature on optimum currency areas, labour mobility has been identified as one of the key factors for a successful currency union.<sup>66</sup> Free movement of labour assumes a greater significance under a single currency. If one Member State is experiencing fast growth while another is suffering a slowdown, the workers may move from the latter to the former. This compensates for the loss of independence in interest and exchange-rate setting—it offers flexibility. The problem for Europe is that free movement of workers remains largely words on paper, with only a small percentage of EU nationals taking advantage of their right to move to another country for employment.<sup>67</sup> In fact, the low level of actual labour mobility in

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<sup>65</sup> JA Frankel and AK Rose, 'The Endogeneity of the Optimum Currency Area Criteria' (1998) 108 *The Economic Journal* 1009.

<sup>66</sup> RA Mundell, 'A Theory of Optimum Currency Areas' (1961) 51 *The American Economic Review* 657.

<sup>67</sup> See further chapter 13.

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In the same vein, well-functioning European capital and credit markets could better smooth economic shocks, which is particularly important as there are no substantial fiscal transfers – public risk sharing can be replaced by private risk sharing. A European Commission study from 2016 estimated that in the US the fully integrated markets meant that less than 20% of shocks went unsmoothed.<sup>69</sup> The smoothing was primarily the result of private risk sharing through markets: over 70% of economic shocks were smoothed privately. By contrast, in the EU over 75% of shocks went completely unsmoothed. Private risk sharing only amounted to little over 20%. This is why the Commission has identified the creation of a Capital Markets Union as a key priority.

Fourthly, and more broadly, a well-functioning internal market allows the real exchange-rate channel to work. What this means is that a country whose economy is overheating due to low real interest rates, which result from a centrally set nominal interest rate and a high level of inflation, is automatically cooled down. Due to the high inflation, its goods and services become more expensive so its export sector suffers. The weakening export sector stabilizes the system. By contrast, in a country that is experiencing a slowdown due to an excessively high real interest rate, which results from a centrally set nominal interest rate coupled with low inflation, the export sector is going to accelerate. The low inflation will make its goods and services cheaper, and its export performance will be boosted. This again stabilizes the system automatically. The problem for the EU is that weaknesses in the internal market which, for example, still covers services only partially, have meant that the real exchange-rate

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<sup>68</sup> See eg OJ Blanchard and LF Katz, 'Regional Evolutions' (1992) *Brookings Papers on Economic Activity* 1.

<sup>69</sup> See European Commission, 'Cross-border risk sharing after asymmetric shocks: evidence from the euro area and the United States' (2016) 15 *Quarterly Report on the Euro Area* 7.

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More broadly still, it can be questioned how well the basic idea of a competitive single market model, and the original EMU more broadly, where each Member State is responsible for its own economic policies and then competes with others, fits with the reality of the single currency. The divergences between Member States that are perfectly acceptable in a single market are deeply problematic in a single currency area. In the past, when Germany's productivity growth was high and Italy's low, Italy could always respond by devaluing the lira. That is no longer an option. Instead, a painful internal devaluation looms. The crisis has also shown that eurozone countries are highly interconnected. When a number of countries got into trouble, this proved to be a problem for the entire eurozone; ultimately the stronger countries and the European institutions decided not to let the weaker ones drown but came forward with various rescue mechanisms. Further, within the eurozone, problems of one country can rapidly infect other States. If there are question marks over the health of the banks of one country, markets quickly become worried about the financial institutions of the other countries as well; if the ability of one Member State to stay within the euro is questioned, the markets quickly start to worry about the other countries. In other words, it is in the interest of all euro States to ensure that every euro State is economically healthy. It is not simply a matter of each State looking after its own performance and competing with the

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<sup>70</sup> The dominance of the real interest-rate channel over the real exchange-rate channel has been described well in H Enderlein et al, *Completing the Euro: A Road Map towards Fiscal Union in Europe—Report of the 'Tommaso Padoa-Schioppa Group'* (Paris: Notre Europe, 2012).

<sup>71</sup> See eg H Van Rompuy et al, 'Towards a Genuine Economic and Monetary Union', available at [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/134069.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/134069.pdf) at 10.

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For example, the important Five Presidents' Report of 2015 calls for a new convergence process towards the best performance and practices to achieve sound policies and similarly resilient economic structures throughout the euro area under the mantra that the success of monetary union anywhere depends on its success everywhere. Binding EU convergence legislation is suggested primarily for labour markets, competitiveness, business environment and public administrations, as well as certain aspects of tax policy,<sup>73</sup> areas which thus far have largely been beyond the reach of harmonization.

The crisis also demonstrated the need for profound changes in the field of financial services, one of the most important sectors of modern economies. First, the crisis led to a re-fragmentation of the single financial market, as companies repatriated some of their activities, often at the behest of national supervisors. This meant that some of the most tangible gains of the internal market were lost. It also meant that the conditions of competition for non-financial firms diverged, as the availability and cost of capital could vary dramatically between countries. Further, the monetary policy decisions of the European Central Bank lost some of their effectiveness as, for example, the cutting of interest rates might not result in a lower cost of finance on the ground. More broadly, the financial crisis exposed the unhealthy relationship between many Member States and their banks. When individual banks got into trouble, their home States had to rescue them. This increased their national debt and made

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<sup>72</sup> For a succinct review of the issues, see Communication from the Commission, A blueprint for a deep and genuine economic and monetary union: launching a European debate, COM(2012) 777 final.

<sup>73</sup> The report, titled 'Completing Europe's Economic and Monetary Union', was authored by Commission President Juncker in close cooperation with the presidents of the European Council, Eurogroup, European Central Bank and European Parliament, and is available at [https://ec.europa.eu/commission/publications/fivepresidents-report-completing-europes-economic-and-monetary-union\\_en](https://ec.europa.eu/commission/publications/fivepresidents-report-completing-europes-economic-and-monetary-union_en).

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investors doubt the solvency of countries such as Ireland and Spain. It also weakened national banks further, as they often have large holdings of their government's bonds. In other words, national banking and fiscal problems fed into each other. In sum, the single market model where banks and financial service providers were largely regulated, supervised, and ultimately supported by their home countries but operated on a pan-European scale has proven unsustainable.<sup>74</sup>

The move away from the single market paradigm can be seen graphically precisely in the case of financial regulation. This was a sector where the principle of home country control at one time reigned supreme. Every Member State regulated its own financial institutions, which then traded in the whole EU using the single passport that the home country had provided them.<sup>75</sup> The new financial services rules that have been adopted since the financial crisis have abandoned the idea of home country control and moved to a centralized approach with a single rulebook rather than a number of competing and mutually recognized national rules.<sup>76</sup> The banking union, while still incomplete, already includes the Single Supervisory Mechanism where bank supervision has been lifted from individual Member States to the European Central Bank, and also a system of bank rescue and resolution that entails risk mutualization and burden sharing across national borders.<sup>77</sup> The ongoing Capital Markets

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<sup>74</sup> See Communication from the Commission, A blueprint for a deep and genuine economic and monetary union: launching a European debate, COM(2012) 777 final.

<sup>75</sup> See further chapter 14.

<sup>76</sup> For critical overviews, see M Andenas and IHY Chiu, 'Financial Stability and Legal Integration in Financial Regulation' (2013) 38 *European Law Review* 335 and N Moloney, 'EU Financial Market Regulation after the Global Financial Crisis: "More Europe" or More Risks?' (2010) 47 *Common Market Law Review* 1317.

<sup>77</sup> See generally eg K Alexander, 'A Legal and Institutional Analysis of the Single Supervisory Mechanism and the Single Resolution Mechanism' (2015) 40 *European Law Review* 154.



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It is thus possible that through a process of spillback the 'remorseless logic' of monetary integration requires an internal market fit for an economic union<sup>79</sup>—a market that works better and is more uniform and centralized than the one contemplated under the single market paradigm. If so, an acute dilemma emerges. How to manage the relationship between those Member States that have signed up to the euro, and those that have not?<sup>80</sup> We have already got a small taste of this in the context of the EU banking union, which is compulsory for euro countries and voluntary for others. Non-participating Member States were deeply concerned about the possibility that in practice the euro countries would impose their view on the future shape of the internal market on the whole EU. A partial solution for this concern was found in the shape of a complex double majority decision-making mechanism that seeks to safeguard the interests of the outs.<sup>81</sup> The same tension can also be seen in the case law, where the attempt by the European Central Bank to insist that companies involved in certain clearing operations had to be based in the eurozone was successfully contested by the UK, supported by Sweden.<sup>82</sup> However, the matter was not fully settled and similar concerns are likely to

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<sup>78</sup> D Valiante, 'CMU and the Deepening of Financial Integration' in D Busch et al (eds), *Capital Markets Union in Europe* (Oxford: Oxford University Press, 2018) 13.

<sup>79</sup> See further on the relationship between 'microeconomic and macroeconomic constitutions', K Tuori and K Tuori, *Eurozone Crisis: A Constitutional Analysis* (Cambridge: Cambridge University Press, 2014).

<sup>80</sup> See New Settlement for the United Kingdom within the European Union EUCO 1/16, 12–15, for an attempt to deal with the issues. However, this has lapsed following the result of the Brexit referendum.

<sup>81</sup> Regulation 1022/2013 [2013] OJ L287/5, Art 44 as amended.

<sup>82</sup> Case T-496/11 *UK v ECB* EU:T:2015:133.

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To sum up, the nature of market integration has changed in the course of the development of European integration. In the beginning, what was contemplated was a common market that would balance freedom and fairness, and where the political institutions would play the leading role in creating the common market through harmonization. This did not work. The institutions proved unequal to the task. Instead, the Court seized the initiative in cooperation with the Commission and with the eventual support of the Member States. The result was a single market that was based less on harmonization and a level playing field and more on home country control and competition. However, it may be that we are now once again witnessing a shift in the internal market paradigm. The tensions inherent in the single market and the need to support the EMU may be pushing economic integration in a new, more centralized direction.<sup>86</sup>

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<sup>83</sup> See generally on the limits of market integration in the context of different models of capitalism, J Snell, 'Varieties of Capitalism and the Limits of European Economic Integration' (2010–11) 13 *Cambridge Yearbook of European Legal Studies* 415.

<sup>84</sup> See J Payne and E Howell, 'The Creation of a European Capital Market' in Koutrakos and Snell (eds), *Research Handbook on the Law of the EU's Internal Market* (n 44).

<sup>85</sup> See generally N Moloney, 'Capital Markets Union: "Ever Closer Union" for the EU Financial System?' (2016) 41 *European Law Review* 307.

<sup>86</sup> See for a discussion of the themes in the previous sections from the perspective of European economic constitution K Tuori, *European Constitutionalism* (Cambridge: Cambridge University Press, 2015) esp ch 5.

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## **Case study 11.1: Internal market as a source of legitimacy and discontent**

It has been a theme of this chapter that the internal market is not a technical value-free project but rather reflects contentious political choices. This case study seeks to illustrate this by focusing on two developments: the Commission's drive for the 'Europe of results'<sup>87</sup> and Brexit.

The Commission has increasingly sought to rely on the internal market as a source of legitimacy for European integration. In particular, it has attempted to focus on specific projects capable of producing tangible benefits that can be portrayed as examples of the EU working for its citizens. Rather than seeking to advance the internal market on a broad front in the name of economic efficiency, like it did for example with the 1985 White Paper or the original proposal for the Services Directive, it has increasingly concentrated on key sectors or themes that preferably also resonate among the public.<sup>88</sup> The Digital Single Market provides a recent example..

Digital Single Market was one of the ten key priorities for *#TeamJunckerEU*, ie the European Commission under President Juncker. It sought to achieve three things: improve access to digital goods and services, create a regulatory environment favourable to digital networks and services, and use digitalization as a driver for growth. The initiatives were

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<sup>87</sup> The phrase was used by Commission President Barroso in 2006, in the aftermath of the demise of the Constitutional Treaty, see [http://europa.eu/rapid/press-release\\_SPEECH-06-286\\_en.htm](http://europa.eu/rapid/press-release_SPEECH-06-286_en.htm).

<sup>88</sup> See eg Commission Communication, 'Single Market Act II Together for new growth' (2012) COM 573 which outlined 12 'key actions' and was accompanied by a 'Citizen's summary'.

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Some eye-catching results were achieved. A Regulation now ensures the cross-border portability of online content services: if a customer has subscribed for example to a TV streaming service, they can continue to watch the same shows when travelling in another EU country,<sup>90</sup> while a Regulation on geo-blocking now prohibits online sellers from blocking customers' access to their online interface or discriminating against them for reasons of nationality or place of residence.<sup>91</sup> Unfortunately, it is doubtful whether a true breakthrough was achieved.<sup>92</sup> The detail of the rules is characterized by limited ambition or important exceptions. Due to its temporary nature, the cross-border portability does not mean a traveler can subscribe to online services while abroad and continue to enjoy them after returning home. The geo-blocking ban does not cover audiovisual or financial services, nor does it apply to electronic access to copyright protected materials, such as films, music, or games; the online seller is not required to deliver goods cross-border; and the Regulation does not preclude for example special offers that target customers in a particular Member State, differing general conditions of access between Member States, or country-specific online interfaces. The danger with this is that rather than enhancing EU's legitimacy through impressive practical results, the measures may serve to raise expectations that are ultimately

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<sup>89</sup> Commission Communication, 'A Digital Single Market Strategy for Europe' COM(2015) 192 final.

<sup>90</sup> Regulation (EU) 2017/1128 of the European Parliament and of the Council on cross-border portability of online content services in the internal market [2017] OJ L168/1.

<sup>91</sup> Regulation (EU) 2018/302 of the European Parliament and of the Council on addressing unjustified geo-blocking and other forms of discrimination based on customers' nationality, place of residence or place of establishment within the internal market [2018] OJ L601/1.

<sup>92</sup> Adamski (n 40) 737.

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This emerged particularly strongly in the debates on the UK's position in the EU and the free movement of workers and the referendum result.<sup>94</sup> Hundreds of thousands of migrant workers, in particular from countries such as Poland, had entered the British labour market relying on the EU freedoms. From their perspective, as well as from the perspective of many well-off Britons, this was a boon. Migrant workers were able to benefit from opportunities not available in their home countries. British businesses had access to cheap labour and middle classes could employ builders and nannies at an affordable cost. However, for many unskilled British workers the immigrants were perceived as a source of competition and a force that kept their earnings down.<sup>95</sup>

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<sup>93</sup> The Political Guidelines that the new Commission President, Ursula von der Leyen, has set out emphasize the need to ensure that the European economy works for people, eg by strengthening Europe's social pillar. See [https://ec.europa.eu/commission/sites/beta-political/files/political-guidelines-next-commission\\_en.pdf](https://ec.europa.eu/commission/sites/beta-political/files/political-guidelines-next-commission_en.pdf).

<sup>94</sup> See eg MJ Goodwin and O Heath, 'The 2016 Referendum, Brexit and the Left Behind: An Aggregate-level Analysis of the Result' (2016) 87 *The Political Quarterly* 323, 331, and SO Becker, T Fetzer and D Novy, 'Who voted for Brexit? A comprehensive district-level analysis' (2017) 32 *Economic Policy* 601, 605.

<sup>95</sup> Since 2007, the UK had experienced one of the largest falls of real average wages of any rich country. See *OECD Employment Outlook 2017*, 213, available at [https://www.oecd-ilibrary.org/employment/oecd-employment-outlook-2017\\_empl\\_outlook-2017-en](https://www.oecd-ilibrary.org/employment/oecd-employment-outlook-2017_empl_outlook-2017-en).

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The UK Government sought to deal with the discontent by negotiating exceptions to free movement prior to the referendum. Some limitations were indeed agreed,<sup>96</sup> but for the most part the other EU countries stood firm on the need to safeguard the principle that has been a part of the integration project from the very beginning.<sup>97</sup>

The issue surfaced again during the withdrawal negotiations. For the UK, a full control of immigration was a red line.<sup>98</sup> The EU defended the indivisibility of the internal market, namely the idea that the freedoms of goods, persons, services, and capital constitute an inseparable whole, with the result that the UK could not pick and choose.<sup>99</sup>

From an economic perspective, maintaining all four freedoms is generally thought to be optimal. Under them both products (goods and services) and factors of production (labour and capital) can flow in an efficient fashion.<sup>100</sup> Further, the different freedoms are often factually connected. However, history is full of trade arrangements that do not involve all four elements, and even within the EU some of the freedoms are, and always have been, more developed than others.<sup>101</sup> So in principle, if all parties were to agree, a pick and choose would

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<sup>96</sup> EUCO 1/16, 19–24.

<sup>97</sup> See 'Cameron pins Brexit on EU failure to grant UK brake on migration' *Financial Times*, 29 June 2016.

<sup>98</sup> <https://brexitcentral.com/theresa-mays-speech-lancaster-house/>.

<sup>99</sup> Statement following an informal meeting of 27, available at <http://www.consilium.europa.eu/en/press/press-releases/2016/06/29-tusk-remarks-informal-meeting-27/>, para 4; for the European Parliament, see eg <http://www.europarl.europa.eu/the-president/en/press-room/the-eu-and-the-uk-%E2%80%93-parting-ways-but-working-together-speech-at-the-european-institute-of-the-london-school-of-economics?webaction=view.acceptCookies>.

<sup>100</sup> In a currency union, the free flow of labour is particularly important.

<sup>101</sup> See S Weatherill, 'The Several Internal Markets' (2017) 36 *Yearbook of European Law* 125.

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As a result, since the UK was unwilling to grant free movement of workers, it could not be a part of the internal market. This ruled out the Norwegian model,<sup>103</sup> under which the UK would have left the EU but remained in the EEA, like Norway. Norway is a part of the internal market, but it cannot limit the number of migrant workers from the EU.

A number of other models are available, with more limited access to the internal market. These kinds of issues will feature large in the negotiations between the UK and the EU on their future relations. For example, Switzerland has a thicket of more than 100 bilateral agreements with the EU, and its companies are often able to access the EU market without obstacles. But the Swiss model does not cover services fully and is in any event in trouble. The EU has for a long time been unhappy with its complexity, and following the Swiss decision in a 2014 referendum to limit immigration, the EU made it clear that curbs on the free movement of EU citizens would jeopardize access to the single market. Turkey is in a customs union with the EU, so there is a free flow of goods, but not of persons. However, services are not covered either, and there are also disadvantages for Turkey's trade policy. This leaves the Canadian model. Canada has negotiated a comprehensive economic and trade agreement with the EU.

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<sup>102</sup> See however Editorial Comments in (2019) 56 *Common Market Law Review* 1189 for an argument that the indivisibility of the four freedoms is a principle of EU law.

<sup>103</sup> See on the various models eg J-C Pirijs, 'Which Options Would Be Available for the United Kingdom in the Case of a Withdrawal from the EU?' in PJ Birkinshaw and A Biondi (eds), *Britain Alone!* (Alphen aan den Rijn: Kluwer, 2016).

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In sum, economically the internal market makes the EU as a whole richer. Yet this has not proven enough on its own to legitimize integration. The Commission has sought to remedy this by concentrating on projects that can create tangible results which can be put on display—a prominent example from the recent past is the battle it has waged against mobile phone roaming charges. However, there is a concern that the internal market may serve to exacerbate social divisions within the Member States. This was observable in the UK referendum, where in particular the less well-off voted for Brexit. Unfortunately, the likely result is disappointment. Without free movement of persons, the UK may not be able to retain full access to the internal market, but will have to settle for a less ambitious trading relationship with the EU. The economic consequences of this are likely to overwhelm any

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<sup>104</sup> [https://ec.europa.eu/commission/sites/beta-political/files/revised\\_political\\_declaration.pdf](https://ec.europa.eu/commission/sites/beta-political/files/revised_political_declaration.pdf).



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## 4 The law of the internal market: the power to harmonize

In practice, the law needs to supply two things to establish the internal market. First, there needs to be rules on free movement. These are the subject of other chapters in this book.<sup>106</sup> Secondly, there needs to be a rule that allows the EU to legislate for internal market purposes. In the actual EU of today, there are a number of such rules. The most important among them is Article 114 TFEU.<sup>107</sup> This is the topic of the present section. It will discuss the extent of the power Article 114 TFEU gives to the EU, and the exceptions the same provision contains.<sup>108</sup>

### 4.1 The power

The wording of Article 114(1) TFEU is as follows:

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<sup>105</sup> See already S Clarke, *A Brave New World: How Reduced Migration Could Affect Earnings, Employment and the Labour Market* (London: Resolution Foundation, 2016). For a comprehensive survey of the various economic predictions, see Tetlow and Stojanovic (n 52).

<sup>106</sup> See especially chapters 12–15.

<sup>107</sup> According to Art 4(2) TFEU, the internal market is a shared competence between the EU and the Member States.

<sup>108</sup> See on the issue of the choice of legal basis in the context of Art 114 TFEU, C Barnard, *The Substantive Law of the EU: The Four Freedoms* (6th edn, Oxford: Oxford University Press, 2019) ch 14.

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achievement of the objectives set out in Article 26. The European Parliament and the Council shall, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.

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There are a number of points that can be made about this. The first three can be taken quickly. First, Article 114 TFEU is a residual provision. It can only be used if other legal bases are not available.<sup>109</sup> For example, Article 50 TFEU contains a specific legal basis for the right of establishment. Secondly, the procedure under Article 114 is the ordinary legislative procedure, which means majority voting in the Council. This was the key innovation of the SEA. However, the second paragraph of the same provision states that this does 'not apply to fiscal provisions, to those relating to the free movement of persons nor to those relating to the rights and interests of employed persons.' These matters were considered too sensitive by the Member States. Thirdly, Article 114 allows the EU to adopt 'measures'. This means that the legislature has the discretion to choose the legal instrument most suitable for the issue in hand; it is not bound to employ only directives, as is the case under a number of other legal bases.

Fourthly, the measures adopted must have as their object the establishment and functioning of the internal market,<sup>110</sup> as defined in Article 26 TFEU. Harmonization cannot

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<sup>109</sup> See eg Case C-533/03 *Commission v Council* [2006] ECR I-1025 for an illustration.

<sup>110</sup> See G Davies, 'Democracy and Legitimacy in the Shadow of Purposive Competence' (2015) 21 *European Law Journal* 2 for a critical examination.

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By way of comparison, in the US the Commerce Clause of the Constitution, which gives the Congress the power 'to regulate commerce ... among the several states' has been used as the basis of very broad legislation, including the New Deal that was the response to the Great Depression of the 1930s and the Civil Rights Act of 1964. This federal legislative activity has been at the expense of the powers of the states. Between 1937 and 1995 the Supreme Court accepted all measures put forward by the Congress under the Commerce Clause, but more recently it has begun to exercise some control over the power, for example striking down the Gun-Free School Zones Act that made it a federal criminal offence to carry a firearm near a school. The Congress had adopted the Act on the basis of the power to regulate interstate commerce, but the Court found the nexus between commerce and the possession of firearms near schools too tenuous.<sup>112</sup> In other words, the power to regulate commerce can be interpreted as an almost unlimited legislative power; it depends on the attitude of the judiciary whether this is sustainable.<sup>113</sup>

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<sup>111</sup> For a recent exploration, see S Weatherill, 'The Competence to Harmonise and Its Limits' in Koutrakos and Snell (eds), *Research Handbook on the Law of the EU's Internal Market* (n 44).

<sup>112</sup> *United States v Lopez* 514 US 549 (1995).

<sup>113</sup> See EA Young, 'Protecting Member State Autonomy in the European Union: Some Cautionary Tales from American Federalism' (2002) 77 *New York Law Review* 1612 for a comparison between the US and the EU.

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The reach of Article 114 TFEU was confronted in the case of *Tobacco Advertising*.<sup>114</sup>

This case is considered in detail in Case study 11.2. The key points bear repeating. Article 114 does not provide a general power to regulate the economy. This would go against the very idea of the EU with limited powers. Instead, measures adopted under it must genuinely seek either to establish the internal market or to improve its functioning. This boils down to two things: either the measure must eliminate obstacles or it must deal with appreciable distortions of competition. As the Tobacco Advertising Directive on the facts did neither, the Court annulled it.

*Tobacco Advertising* sent an important signal. Article 114 TFEU was not without limits, and the Court was prepared to police them. However, it did not lead to a more general wave of successful litigation. The Court's attitude remains permissive to the EU institutions. Particularly instructive in this respect is the ruling in *Swedish Match*.<sup>115</sup> It concerned a Directive adopted under Article 114 that banned all tobacco for oral use, except tobacco for chewing or smoking. This ban included snus, a type of tobacco placed between lip and gum popular in Sweden. It was argued by Swedish Match that the Directive did not in fact contribute to the internal market: how could the ban of a product establish or improve the internal market? The Grand Chamber of the Court rejected the argument. It ruled that national laws concerning tobacco for oral use were developing in different directions, which was creating obstacles to trade. This justified action by the EU legislature, which could, if appropriate, even prohibit the marketing of a product. One possible way of explaining the ruling is that the Court upheld the ban of a particular type of product to allow the circulation of others. A directive might, for example, prohibit dangerous widget types so that only safe widgets remain on the market and can be traded freely. On the facts, this does not seem a

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<sup>114</sup> Case C-376/98 *Germany v European Parliament and Council* [2000] ECR I-8419.

<sup>115</sup> Case C-210/03 *Swedish Match* [2004] ECR I-11893.

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convincing explanation, however. All oral tobacco products were banned, apart from smoking or chewing tobacco. It is not easy to see how this improved trade. When *Swedish Match* is looked at together with other cases decided after *Tobacco Advertising*, it seems that the practical limits of Article 114 are very wide indeed.<sup>116</sup> In fact, in the context of Treaty reform, the remit of Article 114 was singled out as a key question,<sup>117</sup> although in the end the Lisbon Treaty did not amend it. However, the fact that the Court has failed to police the competence limits of Article 114 TFEU strictly does not mean that there is no judicial control of harmonizing measures at all; in recent years the Court has begun to scrutinize vigorously the compliance of EU legislation with fundamental rights.<sup>118</sup>

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<Start Feature>

### **Case study 11.2: Tobacco advertising**

Can the EU ban tobacco advertising in Member States in order to achieve or improve the internal market, or would this go beyond the remit of Article 114 TFEU? Behind this question are important issues of principle: is the EU competent to regulate all economic activity, even against the objections of an individual Member State, given the majority voting under the provision? How far can the EU go in the name of the internal market in matters related to human health and other non-economic issues, given that the Treaty sets strict limits on its powers to regulate, for example, public health as such?

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<sup>116</sup> See D Wyatt, 'Community Competence to Regulate the Internal Market' in M Dougan and S Currie (eds), *50 Years of the European Treaties: Looking Back and Thinking Forward* (Oxford: Hart Publishing, 2009).

<sup>117</sup> See the Laeken Declaration on the Future of the European Union, adopted by the European Council on 15 December 2001.

<sup>118</sup> See in particular Case C-293/12 *Digital Rights Ireland* EU:C:2014:238, discussed in Chapter 9.

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The idea of regulating tobacco advertising at the level of the EU has been around since 1984. However, it was only in 1998 that the EU legislature produced a Directive to tackle the issue generally.<sup>119</sup> Essentially the Directive banned all tobacco advertising. The legal basis selected was Article 114 TFEU. This meant that Germany, which opposed the Directive, could not veto it, but was outvoted. Germany, after losing the political battle, began a legal battle and challenged the validity of the Directive on a number of grounds, including the ground that it could not be validly adopted under Article 114 at all. This was not a surprise. Already in the legislative process it had been suggested that Article 352 TFEU, which requires unanimity in the Council, would be the correct legal basis; reportedly this was also the view of the Council Legal Services.<sup>120</sup>

The first argument that the Court confronted was that the Directive was in reality a health protection measure, not an internal market one, and that the Treaty specifically excluded any harmonization for the protection of human health. The Court acknowledged that the ban on health harmonization should not be circumvented. However, this does not mean that an internal market measure could not have any effect on health. In fact, health requirements have to be taken into account in all EU policies, and Article 114(3) expressly requires that a high level of human health protection be ensured. In other words, the Court explicitly recognized that in the internal market economic and non-economic issues are inextricably intertwined. When the market is regulated, this always impacts on other concerns; yet it does not make market regulation health regulation.

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<sup>119</sup> European Parliament and Council Directive 98/43/EC on the approximation of the laws, regulations and administrative provisions of the Member States relating to the advertising and sponsorship of tobacco products (OJ [1998] L213/9).

<sup>120</sup> See para 17 of the Opinion of AG Fennelly in *Tobacco Advertising* (n 114).

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While the Court accepted that health reasons could even be 'decisive'<sup>121</sup> in an internal market directive, it did not accept that Article 114 TFEU gave the EU legislature a general power to regulate the market. Such a finding, said the Court, would be incompatible with the principle of conferred powers in Article 5 TEU. This was important. In the past, no one had been particularly concerned about the exact limits of the EU's powers. This was because the legislative process had operated under unanimity. When only measures that all Member States supported could pass, the precise limitations of EU competences had seemed an insignificant issue, and certainly no Member State had a reason to bring an action. With the abolition of national vetoes this changed. Member States that could no longer exercise complete control over the EU's political process suddenly became much more conscious of the legal limits.<sup>122</sup> This was something national courts had also picked up on.<sup>123</sup> In its ruling the Court responded.

Instead of a general power to regulate the economy, the Court continued, Article 114 TFEU provided two specific powers. First is the competence to establish the internal market, in other words to eliminate obstacles to free movement. The second is the competence to improve the functioning of the internal market, in other words to eliminate distortions of competition. The question to decide was whether the Directive did either of these things.

Elimination of obstacles is a familiar concept in internal market law. What exactly is an obstacle to one of the four freedoms is the central issue of EU economic law and is discussed elsewhere in the book.<sup>124</sup> The key point to note here is that the Court created a direct linkage

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<sup>121</sup> *Tobacco Advertising* (n 114) para 88.

<sup>122</sup> JHH Weiler, *The Constitution of Europe: 'Do the New Clothes Have an Emperor?' and Other Essays on European Integration* (Cambridge: Cambridge University Press, 1999) 39–74.

<sup>123</sup> *Brunner* [1994] 1 CMLR 57.

<sup>124</sup> See further chapters 13 and 15.

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between Article 114 TFEU and provisions such as Article 34 TFEU on free movement of goods: the wider the reading of the notion of obstacle, the wider the power to harmonize. In *Tobacco Advertising*, the Court added a couple of further points. Article 114 can be used to prevent the emergence of future obstacles to trade that could arise if national laws developed in different directions. It is not only for the elimination of existing barriers. However, the mere finding of disparities between national laws and an abstract risk of obstacles is not sufficient to justify the use of Article 114, and if it is future obstacles that are targeted, their emergence must be likely. On the facts, there was indeed a danger that barriers could arise, for example for the free movement of magazines or newspapers. A newspaper including tobacco advertisements legal in one country could be denied access into the market of another country that banned such advertisements. However, the Directive went much further than this. It also banned things such as umbrellas or ashtrays containing the logo of a tobacco company, and advertisements in cinemas. This did not facilitate trade. The Directive also failed to provide that products complying with it could move freely. Instead, Member States remained free to ban even those few goods that did conform to it.

For distortions of competition, the Court emphasized that only the elimination of appreciable distortions could justify recourse to Article 114 TFEU. Otherwise, the powers of the EU legislature would in practice be unlimited. After all, any differences between national rules can be said to affect conditions of competition at least indirectly. The Court accepted that differences between the laws of Member States on tobacco advertising could in certain circumstances indeed distort competition appreciably. For example, the organizers of a car race might decide to move the event to a country where sponsorship by tobacco companies was legal. However, the Directive was not limited to these kinds of issues but went much further. In this context, the argument that advertising agencies established in countries with the fewest restrictions had a competitive advantage was rejected by the Court. While such



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The result was that the Tobacco Advertising Directive was annulled by the Court. For the first time, a general EU legislative measure was struck down for a lack of competence. This was not the end, however. A few years later, a new Directive was adopted.<sup>125</sup> It was much more closely tailored to the internal market concerns.<sup>126</sup> Again, Germany challenged it. This time the Grand Chamber of the Court, noting the more limited reach of the second Directive, allowed it to stand.<sup>127</sup> In other words, the EU can regulate those aspects of tobacco advertising that can have implications for free movement or lead to real distortions of competition, but it cannot just ban all tobacco advertising in the Member States in the name of the internal market.<sup>128</sup>

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The fifth point about Article 114(1) TFEU is that it only gives the power for 'the approximation of the provisions laid down by law, regulation or administrative action in Member States'. In other words, under the provision the EU can bring national laws closer to

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<sup>125</sup> European Parliament and Council Directive 2003/33/EC on the approximation of the laws, regulations and administrative provisions of the Member States relating to the advertising and sponsorship of tobacco products (OJ [2003] L152/16).

<sup>126</sup> See generally S Weatherill, 'The Limits of Legislative Harmonization Ten Years after Tobacco Advertising: How the Court's Case Law has Become a "Drafting Guide" ' (2011) 12 *German Law Journal* 827.

<sup>127</sup> Case C-380/03 *Germany v European Parliament and Council* [2006] ECR I-11573.

<sup>128</sup> Tobacco-related cases have continued to emerge, eg as unsuccessful challenges to Directive 2014/40/EU on the manufacture, presentation and sale of tobacco and related products (OJ [2014] L127/1), which bans menthol cigarettes, imposes limitations on e-cigarettes and sets out requirements for health warnings etc on cigarette packets.

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that is unrelated to pre-existing<sup>129</sup> or anticipated<sup>130</sup> national laws. Thus, national trademark laws could be harmonized under Article 114, but a new EU-wide trademark could not be established using it.<sup>131</sup> While national company laws were approximated using internal market powers, a new European public limited company form, *Societas Europaea*, was based on Article 352 TFEU.<sup>132</sup>

The Court had to confront the precise limits of the requirement of approximation in *ENISA*.<sup>133</sup> The EU legislature had established ENISA, the European Network and Information Security Agency, under Article 114 TFEU. This followed a series of earlier directives that regulated electronic communication networks and services. The role of the agency was to help the Commission and the Member States on network and information security matters, ensuring the smooth functioning of the internal market. Its tasks included the identification of risks, the development of common methodologies for the prevention of security issues, the promotion of the exchange of best practice, and generally enhancing cooperation in the area of network and information security. The UK argued that Article 114 only allowed the harmonization of national laws, not the creation of new EU bodies. The test in the view of the UK was whether the result of the measure could be achieved if all Member States produced identical laws. The UK argued that since the establishment of ENISA was beyond the capacity of individual Member States, it did not qualify as a harmonizing

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<sup>129</sup> Case C-436/03 *European Parliament v Council* [2006] ECR I-3733, para 44.

<sup>130</sup> Case C-58/08 *Vodafone* [2010] ECR I-4999, which adopts a particularly permissive approach.

<sup>131</sup> Opinion 1/94 [1994] ECR I-5267, para 59.

<sup>132</sup> Council Regulation (EC) No 2157/2001 on the Statute for a European company (OJ [2001] L294/1).

<sup>133</sup> Case C-217/04 *UK v European Parliament and Council* [2006] ECR I-3789. See also eg Case C-66/04 *UK v European Parliament and Council* [2005] ECR I-10553 (smoke flavourings).

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measure. The Grand Chamber of the Court, disagreeing with Advocate General Kokott, held that the regulation setting up the agency was valid. The Court reasoned that the legislature was entitled to establish a body to contribute to the harmonization process when the adoption of various supporting measures would help the uniform implementation and application of other harmonizing measures. However, the tasks of such a body had to be closely related to the previous EU internal market legislation. On the facts, the Court decided that this was the case.

The ruling in *ENISA* is important. Without it, the creation of new agencies would have to be based on the cumbersome Article 352 TFEU, which requires unanimity.<sup>134</sup> The EU legislature has taken advantage of the relatively permissive attitude of the Court.<sup>135</sup> In the context of the financial crisis that began in 2007, it has established a set of important new financial supervisory authorities to deal with banks, securities and markets, and insurers and occupational pension providers. While ENISA's tasks concerned advice and cooperation, the European supervisory authorities have much wider powers, including the power to impose binding decisions.<sup>136</sup> Again, a legal challenge proved unsuccessful, with the Court holding that Article 114 TFEU could confer on the European Securities and Markets Authority (ESMA) the power to take binding measures directed at specific natural or legal persons and overriding national decisions.<sup>137</sup>

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<sup>134</sup> See on 'agencification' HCH Hofmann 'European Regulatory Union? The Role of Agencies and Standards' in Koutrakos and Snell (eds), *Research Handbook on the Law of the EU's Internal Market* (n 44).

<sup>135</sup> For another example, see Commission Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law, COM(2011) 635 final.

<sup>136</sup> See E Fahey, 'Does the Emperor have Financial Crisis Clothes? Reflections on the Legal Basis of the European Banking Authority' (2011) 74 *Modern Law Review* 581.

<sup>137</sup> Case C-270/12 *UK v European Parliament and Council* EU:C:2014:18. Specifically, the relevant regulation gave ESMA the power to prohibit the short selling of securities.

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## 4.2 The exceptions

So far this section has discussed the power that Article 114 TFEU gives the EU. We finally turn to the qualifications contained in the same article.<sup>138</sup> Essentially, these qualifications represent a compromise. The countries with high standards in matters such as health and safety or the environment were concerned that under majority voting Article 114 could result in the lowering of the level of protection. The price for the acceptance of majority voting was a commitment to high standards, incorporated into Article 114(3), and possibilities for derogation, now found in paragraphs 4 to 10.

Article 114(4) TFEU provides a derogation for *pre-existing* national rules. It allows a Member State to maintain a higher level of protection than envisaged in a harmonization measure. This is subject to two qualifications. Only major needs listed in Article 36 TFEU or the protection of the environment or the working environment can justify a derogation, and the Commission must be notified. Article 114(5) provides a derogation for *new* national rules that have been adopted after harmonization. Again, a number of conditions, which are cumulative, need to be fulfilled.<sup>139</sup> There needs to be new scientific evidence. The evidence must relate to the environment or the working environment. There must be a problem that is specific to the relevant Member State and that has arisen after harmonization. Again, the Commission must be notified. Article 114(6) sets out the procedure that the Commission must follow when it receives a notification. In most cases it will have six months to decide whether to approve or reject the national measure. The criterion is whether the national measure is a means of arbitrary discrimination or a disguised restriction on trade between

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<sup>138</sup> See generally I Maletić, 'Derogations from the Regulation of Free Movement: Article 114 TFEU' Koutrakos and Snell (eds), *Research Handbook on the Law of the EU's Internal Market* (n 44).

<sup>139</sup> See eg Joined Cases C-439/05 and 454/05 P *Land Oberösterreich* [2007] ECR I-7141.

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Member States and whether it constitutes an obstacle to the functioning of the internal market. It is important to note that the national rule is unenforceable against an individual relying on the direct effect of an EU harmonizing measure until Commission approval has been gained.<sup>140</sup> In other words, the Commission decision has a constitutive effect. If recourse to a derogation proves justified, the Commission is under an obligation to consider whether the existing harmonization measures need to be adapted or new ones adopted. In this way, the experiences of individual Member States can serve to inform EU harmonization.

The introduction of derogations to Article 114 TFEU was originally met with grave concern.<sup>141</sup> The worry was that Member States would routinely turn to them, frustrating the whole objective of Article 114. These fears have not materialized.<sup>142</sup> It seems that the Member States have been committed to the internal market, the standards of protection have generally been sufficiently high, and the onerous conditions for the derogations have discouraged reliance on them.

To sum up, Article 114 TFEU gives the Union the crucial power to harmonize in the name of the internal market. Its use does not require unanimity. In practice, it has been utilized frequently. The power is a wide one, but not without limits. In particular, it does not give the EU legislature a general competence to regulate the economy, only the competence to deal with obstacles or appreciable distortions of competition. It is only available for approximation, not for the creation of things such as new EU intellectual property rights or

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<sup>140</sup> Case C-319/97 *Kortas* [1999] ECR I-3143. However, if the Commission fails to adopt a decision within the time limit, the national provisions are deemed to have been approved.

<sup>141</sup> See eg P Pescatore, 'Some Critical Remarks on the "Single European Act" ' (1987) 24 *Common Market Law Review* 9.

<sup>142</sup> See eg Barnard, *The Substantive Law of the EU* (n 108) ch 14.

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## **5 The law of the internal market: the types of harmonization**

The final issue to be addressed in this chapter concerns the types of harmonization employed by the EU, and their legal implications. What kinds of measures are adopted under Article 114 TFEU and under other internal market legal bases? Various typologies could be offered. The present section concentrates on total and minimum harmonization,<sup>143</sup> which form the two paradigm cases,<sup>144</sup> and which represent quite different approaches.

Total harmonization was the predominant method of approximation in the early years of the EU, and is still employed today. In fact, as discussed in section 3.2, in some areas it has enjoyed something of a renaissance.<sup>145</sup> Total harmonization takes place when an EU measure, such as a directive, regulates something exhaustively, not leaving any room for divergent rules of the Member States. For example, a directive on widgets could lay down all the features and characteristics that widgets must comply with. Given that it is a directive, Member States would have to transpose its contents into their national law. However, they

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<sup>143</sup> Similarly, M Dougan, 'Minimum Harmonization and the Internal Market' (2000) 37 *Common Market Law Review* 853.

<sup>144</sup> An analytically more precise typology would be to contrast total with partial harmonization, and maximum with minimum harmonization, based on a distinction between the coverage and the level of regulation. See also M Klamert, 'What We Talk About When We Talk About Harmonisation' (2015) 17 *Cambridge Yearbook of European Legal Studies* 360, 362. However, in practice, total and maximum harmonization entail similar legal consequences, as do partial and minimum harmonization.

<sup>145</sup> See also eg European Parliament and Council Directive 2011/83/EU on consumer rights (OJ [2011] L304/64).

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Total harmonization has another important legal consequence: a national rule that complies with an EU measure totally harmonizing something is no longer open to challenge on the basis of the four freedoms of the Treaty.<sup>147</sup> The Member State can defend its national law against such a challenge by simply saying that the law is fully in line with the EU measure. Any challenge would have to demonstrate that the law somehow fails to respect the relevant EU measure.

Nevertheless, an EU measure harmonizing an area totally is not immune to legal scrutiny. A challenge could be brought on the grounds that the EU measure itself violates some higher ranking rule or principle of EU law. However, the crucial difference is that the question would be whether the EU measure violates EU law, not whether a national measure violates EU law. In these kinds of circumstances, the Court of Justice has traditionally taken a hands-off attitude and only struck down EU measures if they manifestly infringe the Treaty.<sup>148</sup>

Minimum harmonization sets the floor below which no Member State may go, but leaves them free to adopt more demanding rules. In this way, it is respectful of the national diversity that total harmonization suppresses. For example, the widget directive could just specify the minimum safety features that every widget must at the very least meet, but give the Member States the option to impose more stringent requirements. Minimum harmonization has often been used in the context of issues such as the protection of the environment or consumers, where some Member States have wished to impose or maintain tougher rules than the others.

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<sup>146</sup> See eg Case 5/77 *Tedeschi* [1977] ECR 1555.

<sup>147</sup> See eg Case C-324/99 *DaimlerChrysler* [2001] ECR I-9897.

<sup>148</sup> See eg Case C-233/94 *Germany v European Parliament and Council* [1997] ECR I-2405.

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A national law that goes beyond the requirements of the minimum harmonization measure would not enjoy immunity from the Treaty. Rather, any national rule would be open to challenge on the ground that it violates a Treaty free movement provision.<sup>149</sup> In this way, the Treaty forms the ceiling above which the Member States are not permitted to go. The mere fact that, say, a directive has authorized Member States to adopt more stringent rules on widgets, does not mean that those rules acquire immunity from the four freedoms if they are applied in a cross-border context.

Unfortunately, it is not necessarily easy in practice to decide whether a particular EU act seeks to bring about total harmonization or to leave Member States free to adopt stricter rules or to rely on grounds not listed in the measure. For example, the Services Directive,<sup>150</sup> which is an important piece of EU legislation that was designed to improve the operation of the single market in services, lists a number of grounds that Member States may use to limit service provision. However, there was a debate about whether these are the only grounds Member States can still rely on, which would correspond with the idea of total harmonization, or whether they are still free to invoke other reasons as well.<sup>151</sup> Ultimately, the matter boils down to the interpretation of the relevant harmonization measure,<sup>152</sup> and this may not always be an easy task. In fact, in the context of the Services Directive the Court chose to dodge the issue.<sup>153</sup>

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<sup>149</sup> See eg Case C-382/87 *Buet* [1989] ECR 1235.

<sup>150</sup> European Parliament and Council Directive 2006/123/EC on services in the internal market (OJ [2006] L376/36).

<sup>151</sup> See eg C Barnard, 'Unravelling the Services Directive' (2008) 45 *Common Market Law Review* 323, 367.

<sup>152</sup> See eg Case 148/78 *Ratti* [1979] ECR 1629.

<sup>153</sup> Case C-179/14 *Commission v Hungary* EU:C:2016:108 para 116.



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To sum up, the EU legislative process produces different types of measures; the two paradigm cases are total and minimum harmonization. The legal consequences of the different types of harmonization vary. Member State compliance with a measure of total harmonization means that it cannot be criticized on the basis of the four freedoms, while a Member State going beyond the requirements of minimum harmonization must ensure that its national law is in line with the Treaty free movement rules.

## **6 Conclusion**

The internal market has been at the heart of the European integration project from the beginning. However, there is no consensus on its fundamental nature and it has changed over time. Three possible ideal models can be distinguished: host country control, harmonized model, and home country control, based on the allocation of legislative power. The models represent fundamentally different philosophies of market integration, and entail different consequences for sovereignty, the balance of legislative and judicial powers, the protection of public policy interests, and democracy. In the historical experience of the EU, no model has been adopted in a perfect form. Nevertheless, when the integration moved from the original common market model to single market it did take a step towards the home country model and away from the harmonized model. The single market paradigm has not proven stable. In practice, the ideas of mutual recognition and regulatory competition have encountered resistance and created only limited market integration. It is possible that the internal market is shifting towards an economic union paradigm.

Whatever the model or the paradigm of the internal market, legally two things are needed: there need to be rules on free movement and a conferral of legislative power to the EU. The latter was the subject of this chapter. The key provision is Article 114 TFEU that gives the EU the competence to harmonize in order to achieve or improve the internal market. This is a

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broad power but not without its limits. The Court of Justice has found that it allows the EU legislature to deal with obstacles to trade and with appreciable distortions of competition. Another limit is that the power is there for the approximation of national rules, not for the creation of new free-standing EU rights or things unrelated to Member State laws. The exact contours of this are subject to an important debate. It needs to be noted that the harmonization that the EU engages in can take different forms. Particularly important types are total and minimum harmonization, which entail different legal consequences.

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