# 5

# Emerging EC Commercial Policy

EC commercial policy is still in its infancy, as it is for most WTO members, but it has already had to cope with topics that, for better or worse, attracted a lot of attention at the Seattle WTO Ministerial: services, trade and labor, trade and competition, public procurement, trade-related intellectual property rights (TRIPS), and investment. This policy is not yet driven by EC Uruguay Round liberalization commitments simply because, so far, as for all WTO members, these are limited, and in some cases even nonexistent. The 1995 Uruguay commitments in services and the 1997 agreements on basic telecommunications (hereafter telecoms) and financial services are mostly standstill commitments. WTO commitments on public procurement consist of general principles to be followed in bidding procedures, and of a list of agencies and bodies that must abide by these principles. And WTO negotiations on international investment, trade-related competition, and labor issues may never be launched. The only topic of commercial policy with EC commitments is TRIPS, but it is included in a much wider, older framework of international treaties.

In the absence of WTO commitments, emerging EC commercial policy is largely shaped by another force: the Single Market Program (SMP). As mentioned in chapter 4, the SMP was launched by a group—the European Round Table of Industrialists—that did not want the scope of reforms to be undertaken by the EC to be limited to manufacturing. The ERT 1985 Plan included opening to intra-EC competition key nonmanufacturing activities, such as telecoms, transportation and other essential infrastructure services, and public procurement. The SMP was officially initiated in 1985, a few weeks after the ERT Plan. It has necessitated (and still does) the adoption of a large number of EC regulations and other legislative instruments, particularly in services and public procurement, which have been slowly and painfully (as shown in this chapter) in the process of being implemented since the mid-1990s.

The dynamic interactions between EC commercial policy and the SMP are (and will be) shaped by the balance of power between the Community and its member-states. Whereas trade policy (defined as dealing with goods and related topics in the introduction to part II) is under the Community's exclusive competence, EC commercial policy is often under the *joint* competence of the Community and its member-states—but with marked nuances. At one end of the spectrum, the Community is dominant, with the Commission's exclusive power to impose discipline on member-state subsidies and its leading role in merger and competition policy.

At the other end of the spectrum, the Community relies on a narrow treaty basis for labor issues, where it plays a very limited role as catalyst. Services, TRIPS, and public procurement fall between these two extremes. The Nice TEC version (2001) has tilted the balance somewhat toward exclusive Community competence by expanding the qualified majority rule to a range of service and TRIPS issues—although this change is much more modest than it appears at first glance (see below).

This delicate balance of power between the Community and its member-states on commercial policy is in permanent flux under the pressure of two additional, unrelated (indeed often opposed) forces. First, the Community relies on the legal basis established by the Court of Justice in the late 1970s and early 1980s—the 1979 *Cassis de Dijon* ruling and a few other key procompetitive rulings for the various topics covered by commercial policy (in particular the 1982 *British Telecom* ruling regarding access to networks in services). This reliance on a legal corpus, not just on negotiations between member-states, is (and will be for the foreseeable future) a major difference between the SMP and WTO perspectives.[1]

During the first 40 years of the Community, the Court mostly dealt with trade in goods, and its rulings gave clear priority to the elimination of intra-EC obstacles—magnifying trade diversion costs, in particular, when such "obstacles" were in fact sound economic practices. However, since the early 1990s, the Court has recognized the intrinsic difficulties of dealing with trade in services and regulatory matters, and the deep differences among member-states on many key issues such as the role of "service of general interest," tolerance of monopolies, etc. As a result, the Court has left member-states more freedom in these domains (indeed, meanwhile, the Court has evolved in the same direction in the domain of goods, as is best illustrated by its 1993 *Keck and Mithouard* ruling; see chapter 4). The resulting, more balanced approach by the Court culminated in

1. Indeed, there is a striking parallel between the EC Court of Justice and the US Supreme Court on most of the aspects examined in this chapter; for details, see Goodman and Frost (2000).

its 1994 ruling on joint competence of the Community and its member-states for most commercial policy matters the scope of which has been formally reduced by the Nice TEC version.

The second force that has shaped the balance of power between the Community and its member-states (and still does) is European politicians' perspectives. Until the late 1980s, member-states were jealous of their trade policy prerogatives (the communitarization of trade policy has not been an early, rapid, or easy process, as seen in the previous chapters), and most European politicians resisted devolving more power to Brussels. By contrast, since the early 1990s, European politicians have looked much more favorably on harmonization. They refer less and less to the concept of "subsidiarity" (actions should be taken at the lowest efficient layer of decision), much celebrated in the late 1980s and early 1990s, but mentioned only once in the Nice TEC version. And they dismiss the fact that regulatory competition between member-states can be an essential source of cost-efficiency and benefits to the EC (for a thorough analysis of the good economic reasons for diversity across countries in domestic policies dealing with the topics covered by commercial policy, and an explanation of why harmonization is not necessarily a welfare-enhancing proposition, see Bhagwati and Hudec 1996).

However, this politicians' call for harmonization is ambiguous, as is best illustrated by the fate of services and TRIPS in the Nice TEC version. The shift, under this Treaty, of a large group of services from unanimity to qualified majority rule does not represent a dramatic change, for either legal or political reasons. Legally, following the "parallelism" approach (in EC parlance), the unanimity rule in services will continue to prevail for all provisions of international agreements (e.g., on taxation or on social issues) that require unanimity in the adoption of intra-EC decisions. Politically, the history of EC trade policy has amply shown that consensus is still often the de facto rule in the many cases where member-states "trade" their signatures on agreements under the majority rule for their signatures on agreements under the unanimity rule. The range of services left under the unanimity rule (audiovisuals, education, and health and social services; to which one should add transport, which remains governed by specific Treaty provisions) is important and large enough to leave many decisions de facto under the unanimity rule.

What then does the proharmonization shift among European politicians mean? It seems much more a mirroring of the fear of regulatory competition (within the EC, and between the EC and the rest of the world) than a desire to really "harmonize". In fact, harmonization is a very convenient argument for European politicians, for three reasons. First, it allows them to put the blame for the necessary regulatory reforms on "Brussels," in sharp contrast to regulatory competition, which would require hard decisions from member-states. Second, it offers to every member-state the opportunity to include national provisions in European regulations, and hence to possibly "grandfather" domestic regulatory key features, as is best illustrated by the notion of "service of general interest" in services (see below). Third, after the introduction of the euro, harmonization appears as a "must" to many European politicians, who tend to believe that a single currency should bring the same price for the same product all over Europe. Hence they are keen to ensure what they call "fair" competition in Europe—inhibiting, by the same token, the procompetitive effects of the euro, by far its possibly most positive feature.

All these aspects are consistent with the "statist" reaction underlined in chapter 1, and they are illustrated again and again by the typical history of SMP directives in services: The Commission tables a relatively procompetitive draft, which is then copiously peppered with harmonization provisions, which are traded between member-states and powerful incumbent vested interests, and which increasingly limit the scope for regulatory competition, to the satisfaction of the remaining "dirigist" clusters of the Commission.

With these driving forces in mind, it is interesting to look at box 5.1 and table 5.1, which aim to capture the implicit preferences of the three key EC institutions (the Council, the Commission, and the Parliament) on the six topics of commercial policy by examining the texts released by these institutions for the Seattle WTO Ministerial.

Box 5.1 suggests organizing the chapter in six sections. The first section deals with services, an important issue for the three institutions and the most important potential source of gains from liberalization. The second section deals with trade and labor, a dominant topic in the three agendas, despite its negative impact in the WTO forum. The third section looks at competition policy, which is important for the three institutions, despite the limited benefits to be expected from internationalization. The fourth section examines public procurement, a domain surprisingly secondary for the three institutions, despite its often-celebrated large benefits from liberalization (a contradiction that will receive some explanation below). The fifth section looks briefly at TRIPS and investment issues, which are both more marginal, but for different reasons. The concluding section summarizes a few proposals that the EC should ideally table in the coming round of negotiations.

The chapter leads to two general conclusions that shed some light on EC commercial policy in the WTO context. First, EC commercial policy has been deeply permeated by services (the only topic certain to be covered by the coming negotiations under the Uruguay Built-in Agenda) with the SMP core focus on regulatory *convergence* (harmonization), to the detriment of regulatory *competition* (liberalization). If unchanged, this feature will make the EC a difficult partner in the coming WTO negotiations. But it will also make multilateral liberalization of services an attractive opportunity for the EC, because it will boost the incomplete, and still partly reversible, *intra-EC* liberalization—a situation not without similarities to the

**Box 5.1 The EC commercial policy revealed at the Seattle WTO Ministerial**

The topics of commercial policy covered by the texts released for the 1999 Seattle WTO Ministerial by the three European institutions are summarized in table 5.1, following the approach used in table 4.1 (see chapter 4).

These crude measures of the relative importance of the topics related to commercial policy suggest two major lessons. First, the Commission and the Council have relatively similar agendas, with trade and labor as the preeminent issue and public procurement as the least important one. Paradoxically, investment (a domain where the Commission is not much involved) ranks higher than services (one where the Commission has expanded its grip) in the Commission agenda, whereas the contrary is observed for the Council agenda—a twist that may reflect the Commission's attempt to use WTO negotiations as a way to extend its power, and the Council's opposition to such a move. Second, the Parliament differs, surprisingly at first glance, from the Commission and Council. In particular, services attract its attention much more than the trade and labor issue, for reasons explained in the main text.

For each of the six topics covered, table 5.1 aims also to capture the economic "tone" of the Commission text by looking at the frequency with which 15 key terms (and their variations) have been used: five terms are associated with a proliberalization tone (competition, liberalization, market access, mutual recognition, and open [market]), 5 terms suggest a more "neutral" view of liberalization (barriers, disciplines, nondiscrimination, subsidies, and transparency), and 5 terms reflect a reluctant approach to liberalization (progressive, harmonization, regulation, safeguard, and reciprocity). The texts about services are relatively intensive in proliberalization terms (a first view to be seriously qualified in the Parliament case, as shown in the main text), whereas the texts about public procurement and labor are quite balanced. By contrast, the texts about competition, investment, and TRIPS are loaded with reluctant terms (quite unexpectedly for competition).

For the sake of minimizing quotes, the chapter refers to the Commission text, and refers to the two other sources only in cases of noticeable differences among the three texts.

EC Common Market in manufactured goods, which has greatly benefited from subsequent GATT rounds (see chapter 1).

Second, by contrast, the EC has unfortunately not drawn from its *own* internal liberalization the most interesting lessons for the future WTO round. For instance, it did not underline the benefits of focusing de facto on two "modes of delivery" of services (cross-border and establishment), as the EC has progressively learned to do—instead of invoking systematically four modes, as the WTO still does. Nor did the EC make clear the profound reasons that have induced EC member-states (and still do) not to link trade and labor issues *within* the EC. And the EC did not emphasize the fact that priority should be given to *national* competition law *and* its firm enforcement. The EC also did not insist on the fact that its approach to state aid is much better than GATT provisions on countervailing actions. Last, the EC did not recognize the fact that gains from liberalization in public procurement rely more on swift, effective dispute

**Table 5.1 EC preparatory texts for the 1999 WTO Seattle Ministerial: Commercial policy topics**

| | Commission | | Council | | Parliament | |
|---|---|---|---|---|---|---|
| **Topic and ranking criteria** | **Share** (percent) | **Rank** | **Share** (percent) | **Rank** | **Share** (percent) | **Rank** |
| **Topic importance by source[a]: Text length devoted to the topic** | | | | | | |
| Trade and labor | 13.4 | 1 | 15.8 | 1 | 10.0 | 4 |
| Services | 5.8 | 9 | 7.1 | 6 | 15.9 | 1 |
| Investment | 10.1 | 3 | 5.3 | 7 | 4.9 | 10 |
| TRIPS | 3.6 | 11 | 5.2 | 8 | 9.4 | 5 |
| Public procurement | 2.9 | 13 | 4.7 | 10 | 1.7 | 13 |
| Competition | 6.7 | 8 | 4.6 | 11 | 5.4 | 9 |
| Reminder: | | | | | | |
| Trade policy topics[b] | 44.7 | — | 45.1 | — | 45.6 | — |
| Trade and development[c] | 12.7 | 2 | 12.1 | 3 | 7.1 | 7 |
| **"Tone" by topic[d]: Term frequencies** | Services | Public procurement | Competition policy | Trade and labor | TRIPS | Investment rules |
| Proliberalization terms | 43.8 | 25.0 | 9.1 | 33.3 | 0.0 | 7.7 |
| Neutral terms | 37.5 | 37.5 | 36.4 | 33.3 | 0.0 | 23.1 |
| Reluctant terms | 18.8 | 37.5 | 54.5 | 33.3 | 100.0 | 69.2 |
| Number of observations | 16 | 8 | 11 | 3 | 1 | 13 |

TRIPS = Agreement on Trade-Related Aspects of Intellectual Property Rights.
WTO = World Trade Organization.

a. Decreasing order in the Council text.
b. For details, see table 4.1.
c. For details, see chapter 6.
d. Proliberalization terms = competition, liberalization, market access, mutual recognition and open (market). Neutral terms = barriers, disciplines, nondiscrimination, subsidy, transparency. Reluctant terms = harmonization, progressivity, reciprocity, regulation, safeguard.

*Source:* See text of the chapter.

settlement procedures at the disposal of the bidding firms feeling unfairly treated than on transparency per se.

The EC experience suggests a last general lesson. Because liberalization of commercial policy tends to be done through regulatory reforms, the design of appropriate reform measures should not exclusively rely on political trade-offs heavily loaded by vested interests (as it did too often in the past in the EC)—but it should make increasing use of a cost-benefit approach based on economic analyses.

## The EC SMP in Services: In Need of a WTO Boost

In the mid-1980s, the Common Market was limited to the manufacturing sector, amounting only to a fourth or a third of member-state GDP. Most market-based services, representing half to two-thirds of member-state GDP, were left untouched by intra-EC liberalization. To a large extent, this situation reflected the complex provisions of the Treaty of Rome about services, which can be presented in four basic components.

First, the Treaty of Rome relies on the four modes of delivery on which the WTO legal framework is also based. Article 49 (ex 59), which opens the Treaty chapter on services, and Article 39 (ex 48) on labor movement deal with the freedom to provide services in a way that covers both cross-border trade (mode 1 in GATS parlance) and movements of service providers (mode 4). Echoing mode 2 (movements of consumers of services), several articles in the Treaty principle section (for instance, on citizenship) ban restrictions on the free movement of persons. Article 43 (ex 52) bans restrictions on the right of establishment (mode 3 of GATS).

Second, a key issue is whether all these provisions are *directly* applicable (they can be enforced by national courts without specific Community actions) or not (i.e., they require directives to be adopted by the Council of Ministers and translated into member-state laws, i.e., a long process). The international impact of applicability may be considerable. For instance, the second paragraph of Article 49 (ex 59), which is not directly applicable (contrary to the first paragraph), may allow the possibility of discriminatory treatment against non-EC service providers established within the Community—opening the door to an EC reciprocity-based approach to liberalization of services, and to international conflicts.

Article 39 (ex 48) on labor movement is directly applicable, as firmly clarified by the *Bosman* ruling of the Court of Justice, as is Article 43 (ex 52) on the right of establishment. Similarly, the Court of Justice has repeatedly stated, since its 1974 *van Binsbergen* ruling, that the first paragraph of Article 49 (ex 59), on the principle of nondiscrimination between EC service providers on a nationality or residence basis, is also directly applicable. In an approach echoing the legal structure for goods (see chapter

4), the 1991 *Stichting Collectieve Antennevoorziening Gouda* ruling of the Court of Justice made clear that the freedom to provide services under Article 49 (ex 59) can be limited by member-state laws *only* to guarantee the achievement of an "essential public interest," and *without* going beyond what is necessary to achieve that objective.

By contrast, the other Treaty provisions on services are not directly applicable. These provisions require that directives be developed and enforced, and that has been the raison d'être of the SMP. Of course, there are "in-between" cases where the applicability issue becomes very complex. For instance, Article 43 (ex 52) on the right of establishment, although directly applicable in principle, requires de facto specific directives in the case of professional services (under Article 47 [ex 57]) to solve the problem of equivalence of diplomas, an absolute prerequisite for opening the markets for these services in an effective way.

Third, two other clauses of the Treaty chapter on services deserve attention because they have deeply shaped SMP coverage. The first clause, in Article 52 (ex 63), reads: "priority [for liberalization] shall as a general rule be given to those services which directly affect production costs or the liberalization of which helps to promote trade in goods." It reveals the resilience of the negative perception of the economic role of services in Europe. The distinction between infrastructure and "other" services is biased against a uniform (across-the-board) liberalization of services; it increases the level of effective protection which can be granted to goods. (Liberalizing infrastructure services reduces the costs of producing goods, and hence increases the value added of the domestic production of goods, relative to the value added in foreign production, all other things being constant.) In other words, liberalizing infrastructure services favors trade in goods (if the costs of moving goods decline relative to costs of moving information about goods), or international direct investment in goods (if these relative costs increase).

The second clause of the Treaty on services to be examined more closely is in Article 53 (ex 64): "Member-states declare their readiness to undertake the liberalization of services beyond the extent required by the directives issued pursuant to Article 52:1 (ex 63:1), *if* their general economic situation and the situation of the economic sector concerned so permit." (Author's emphasis) It is thus a safeguard provision for the "other" services, which could be of the utmost importance in the coming WTO negotiations: It can be used by an EC member-state as a legal basis for resisting EC *and* WTO liberalization.

Fourth, in addition to its chapter on services in general, the Treaty of Rome has specific provisions on transport.[2] However, Articles 70 (ex 74) to

2. Article 51 (ex 61) specifically mentions liberalization in banking and insurance services, but only to stress that it should be "effected in step" with the liberalization of movement of capital (see the section below on investment).

80 (ex 84) cover only "land carriers" (roads and inland waterways). Paradoxically, they have been a source of more uncertainty than clarity because they balance liberalization with other objectives (a common transport policy and a regional policy) that have de facto excluded land transport from the general right of establishment under Article 43 (ex 52), and from competition rules, by permitting the long survival of a complex web of price controls, quota licenses, public monopolies, state aid, and so on. The only unambiguously proliberalization provision of these articles is the nondiscrimination principle for EC land carriers under Article 75 (ex 79), but its implementation was left to decisions to be made later, with almost no progress (even in terms of regulatory framework) until the late 1980s.

This brief survey deserves two final remarks. National administrations tend not to be subject to many of the above disciplines, in the name of public order. Moreover, in the late 1980s, many service providers in the EC were public monopolies (or firms to which member-states grant special or exclusive rights) subject to specific Treaty provisions about competition (see below, and the following section on state-owned enterprises).

Only in 1985 did the EC decide to embark on a major effort to introduce the regulatory reforms of services possible under the Treaty of Rome. Following Article 52 (ex 63), it did so only for a limited number of service sectors—those perceived, at that time, as constituting the "infrastructure" of the EC economy: financial services, telecoms, transport (land, air, and sea), and audiovisuals, this last service illustrating the political flexibility of the infrastructure notion. The late 1990s witnessed painful, and not always successful, efforts to extend the list to electronic commerce, electricity and natural gas, railways, and postal services, whereas the early 2000s are expected to focus on additional liberalization in financial services. As a result, the services currently covered by the SMP amount to roughly one fourth of the EC's GDP.

## The SMP in Services: Regulatory Convergence versus Regulatory Competition

The directives adopted under the SMP in services and its successive extensions during the 1990s share a key feature: they focused too much on regulatory convergence, to the detriment of regulatory competition. This is primarily because the principle of mutual recognition de facto was eroded, or even ignored, in the long negotiations between the member-states necessary to draft the compromises embodied in the directive texts—ultimately to the detriment of intra-EC competition in services.

The SMP was not initiated by the member-states or by the Commission but by two landmark rulings of the Court of Justice: the 1979 *Cassis de Dijon* ruling (and its forerunner, the 1974 *Dassonville* ruling), with its key corollary of "mutual recognition" (see chapter 4); and the 1982 *British Telecom* ruling. These were the first of a series of cases confirming the application of competition rules to the service sectors, which in the early 1980s were still largely dominated by public firms or monopolies in the EC that limited access to their networks.

As underlined in chapter 4, the *Cassis de Dijon* ruling raises the crucial issue of the optimal dose of harmonization and mutual recognition. The ruling could have been interpreted as stating the principle of unconditional (or, at least, maximal) mutual recognition in services, and hence of regulatory competition: member-states would have unconditionally accepted cross-border trade in services between them; and they would have unconditionally allowed the establishment of service providers located in other member-states, their operations being regulated by *home* (country-of-origin) disciplines and authorities. Such a fully "home-based" regime would have strongly induced the authorities of each member-state to ensure that their domestic service providers would enjoy competitive advantages by designing and adopting efficient laws and regulations.

The outcome of such a competitive process among member-states could be regulatory convergence or differentiation (depending on the type of services traded, service providers, and consumers, and on the legal capabilities and strategic views on competition of each member-state).[3] Unconditional mutual recognition is not an unrealistic option, as is illustrated by the 1988 draft of the Investment Services Directive on cross-border provision of investment services. The part of this draft directive that deals with stock exchanges combines an EC-wide authorization procedure for market access for investment firms based on mutual recognition with liberalized access to membership in stock exchanges for all EC firms—regardless of their home member-states and without imposing harmonized trading rules, specific market structures for stock exchanges, or transparency requirements (Steil 1996).

But the *final* texts of the directives are almost entirely the outcome of a pure negotiating process between member-states—without the guidance of cost-benefit analyses of the various options for relative doses of harmonization and mutual recognition. This negotiating process leads to a much less liberal approach: mutual recognition then becomes conditional on the adoption of a substantial core of essential requirements, to be embodied in common EC regulations negotiated by member-states.

In other words, the negotiating process has made the SMP a joint exercise about regulatory convergence more than about market access per se.

3. Fears that competing regulations would generate the risks of a "race to the bottom" are frequent, even among associations of consumers (despite the fact that they are the ultimate beneficiaries of more competitive regimes). These fears ignore that member-states are anxious about their "reputation," which induces them to design competitive regulations not detrimental to "quality," all the more because the more countries are integrated, the more powerful reputation effects can be. As for technical regulations (see chapter 4) on trade and labor (see below), strong reputation effects are the best guarantee against a race to the bottom, particularly in democratic, relatively "information-intensive" European societies.

For instance, in the example of the Investment Services Directive, half the member-states, led by France and Italy, have spent four years of negotiations "harmonizing" market structures of EC stock exchanges by loading the final text with the concept of "regulated markets." This concept essentially sought to restrict cross-border liberalization in stock exchanges, in an effort to contain the success of the London Stock Exchange Automated Quotation International (which did not fulfill the definition of a "regulated" market) which was launched by the 1986 "Big Bang" unilateral British regulatory reforms, and threatened the other EC financial markets in the late 1980s (Steil 1996, 1998).

In the line of the *Stichting Collectieve Antennevoorziening Gouda* ruling, the 1995 *Alpine Investment* ruling of the Court of Justice aimed to limit such a drift toward harmonization by stating (1) that the freedom to provide services under Article 49 (ex 59) precludes the application of any national legislation that has the effect of making the provision of services between member-states more difficult than the provision of services purely within one member-state; and (2) that the public interest that member-states could invoke to escape Article 49 (ex 59) must be "essential" (such as the need to protect the reputation of the whole domestic financial sector). The general conclusion of the *Gouda* ruling that "it must not be possible to obtain the same result by less restrictive rules" is the best definition of the optimal dose of harmonization and mutual recognition—but, clearly, member-state negotiators of the SMP in services have often ignored this Court criterion.

Regulatory convergence has an important corollary. By nature, it focuses on trade-offs between regulatory provisions *within* each service sector—a tendency facilitated by the majority voting procedure used for adopting the SMP. It has thus shaped the SMP on a sectoral basis, with little attention devoted to cross-sectoral trade-offs between the services involved. (By contrast, unconditional mutual recognition and liberalization would have tended to focus on trade-offs between concessions given in the various service sectors subject to negotiations.) That regulatory convergence and sectoral approach reinforce each other is an important point for understanding the EC approach in the coming WTO negotiations.

The motive behind the choice of regulatory convergence has been essentially political. Each member-state could then hope to insert parts of its own regulations into the common EC regulations in order to bend the latter as much as possible in its favor. This perspective has made the SMP more palatable to the majority of member-states, which in the late 1980s and early 1990s were still very reluctant to adopt market-oriented regulatory reform of services.[4]

4. Even Britain, the member-state most keen to liberalize, has been less adventurous about competition than about privatization, with its duopoly-based, "heavy-handed" approach to regulatory reform of services, in combination with large powers (including detailed price fixing) devolved to regulatory agencies (Vickers and Yarrow 1988; Stelzer 1991).

This political incentive was amplified by an economic consideration. In the late 1980s, many SMP services in member-states were characterized by large overcapacities in basic services after decades of public overinvestment in a context of controlled prices, massive subsidies, and public monopolies. For instance, in the early 2000s, the electricity sector has an estimated average overcapacity of 20 percent in almost all the EC countries (up to 30 percent in France); retail banking is still provided through vastly oversized networks of agencies; and the telecom networks of railways or public electricity monopolies are hugely oversized (in the mid-1990s, SNCF, the French railways company, was reportedly using only 10 percent of its own telecom network capacity). In such a context, many EC decision makers feared that liberalization could lead to a fast, rough shift from monopoly to competition: oversized electricity producers could almost instantly compete fiercely; railway or electricity monopolies could rapidly become major competitors of telecom monopolies; and so on.[5]

The short-term political benefits derived from regulatory convergence have generated long-term economic costs. First, regulatory competition has been limited to regulations *not* included in the common core, which, almost by nature, were of marginal importance. Second, and much more important, the EC common regulations have been loaded with notions (monetary policy, service of general interest, universal service), instruments (safeguards and other escape clauses), or procedures (progressive liberalization) that have allowed (and still do) strong, determined vested interests to limit or contain for years the *real* magnitude of liberalization.

In such an arcane and contradictory legal framework, SMP proliberalization provisions (such as the directives' repeated condition that prices should reflect costs) are often not powerful enough to allow the elimination of the antiliberalization provisions in a costless, swift, and secure process. Lawsuits become necessary, and because they could easily last a decade (especially if they require rulings from the Court of Justice), they induce complainants and defendants to settle their disputes at lower costs, that is, to negotiate collusive actions.

Examples of the negative impact of regulatory convergence on competition and liberalization abound. For instance, in telecoms, the "universal service" clause has been used as a severe barrier against entrants; requirements to be classified as an operator have often been (and still are) very costly; and the crucial "last-mile" liberalization (the unbundling of the local loop) will not be implemented before 2001 in several member-states, assuming no legal hurdles (see appendix A, case 22). In accounting,

5. In fact, competition would have required time. More electricity exports require more high-tension lines, telecom activities by railway companies require more expertise from telecom operators, etc. It is interesting to note that Britain has been one of the EC member-states least exposed to overcapacity. This factor has been a push for regulatory reform, but also the source of a costly focus on equipment, as is best illustrated by the telecom case (appendix A, case 22).

the Fourth and Seventh Company Law Directive provisions on harmonized requirements have been recognized by Commission officials themselves as having negative consequences for the comparability of accounts that they were supposed to enhance (Trachtman 1997). In audiovisuals, the Television Without Frontiers Directive has opened the door to subsidies that have *restricted* intra-EC trade in movies (see appendix A, case 20). In electricity, so many options for liberalization have been left to member-state discretionary decisions that they have ended up by favoring strong anticompetitive strategic behavior by large incumbent operators, such as Electricité de France.

The negative impact of regulatory convergence on competition can take time to emerge, as in the stock exchange case. During the 1990s, the above-mentioned "regulated market" provision of the investment service directives did not severely curb competition between EC exchanges, although they have generally refrained from directly competing with each other's products. In fact, major Continental exchanges reacted to the threat from the London Exchange by improving their efficiency through reliance on the huge liberalizing power of progress in information technology and its impact on new financial techniques—best illustrated by the envisaged London-Frankfurt merger, for which its leadership in trading and settlement technologies (the Xetra system) has given Frankfurt some leverage over the much more mature London Exchange. But technical progress may soon turn anticompetitive, with new techniques and concentration among EC stock exchanges generating serious risks to trigger the protectionist capacities of the regulated market clause (ESFRC 2000).

The SMP focus on regulatory convergence has had a last important consequence. It has required a long period—more than 15 years—to adopt the SMP initial regulations and to *begin* to implement them. First, it took eight years (1985–93) for the Commission and the Council to elaborate on and negotiate the 54 directives that constitute the *initial* SMP legal framework in services.[6] Second, "transposing" all these directives into member-state laws is also a long process, with a sizable proportion of directives not properly implemented. From 1997 to 1999, there were roughly 200 "reasoned opinions" (mirroring potential conflicts between the Commission and member-states) on the way directives were transposed in member-state laws and regulations, and the number of annual cases referred to the Court increased from 52 to 74 (European Commission 2000a).

As a result of these complications, in May 2000, almost one-fourth of the directives that should have been transposed by 1996 and 1997 had not yet been transposed; this proportion jumps to two-thirds for the directives that were to be transposed by 1998. Delays are concentrated in certain sec-

6. From 1993 to 1997, 36 additional directives for services were adopted. Energy is often associated with services; eight energy directives were adopted between 1985 and 1993, and seven more from 1993 to 1997.

tors: 4 directives out of 18 in telecoms and 32 directives out of 69 in transport were not yet transposed in all member-states. Delays are also concentrated in certain member-states: 17 telecom and transport directives were not yet transposed by Luxembourg and Portugal, 13 by Ireland, and 10 by France.

In sum, it is essential to avoid the confusion often made between the year of *adoption* of a directive and the year of its correct *implementation* in the whole Community. For instance, the last measures opening intra-member-state flights to EC carriers included in the 1992 Third Directive were implemented only in April 1997, 10 years after the adoption of the First Directive on air transport. The First Directive liberalizing basic telecommunications was adopted in 1988, but the first serious steps to open member-state markets occurred only in January 1998 (January 2000 for some states). The 1993 Council Regulation on "road cabotage" began to enter into force only in July 1998; until then, road carriers operated under a quota system.

## The EC in Seattle: Regulatory Convergence and Sectoral Approach

The Seattle texts of the European institutions devote surprisingly little space to services; the topic ranks only fourth in commercial policy issues for the Commission and second for the Council (see table 5.1). The Parliament Resolution seems to reserve better treatment for this domain, but half of its section on services consists of statements limiting the scope of liberalization—from the need for subsidies for minority languages and cultures, to the introduction of notions such as "universal coverage" (universal service), to the complete exclusion of certain services (health, education, and culture) from WTO negotiations.

The EC's initial position in the coming round, as sketched in the Seattle Commission text, has been largely permeated by the SMP focus on regulatory convergence and its sectoral approach—despite the clearly manifested preference of the European business community for procompetitive regulations and a horizontal approach (European Services Forum 1999; Cooke 1999). The Seattle Commission text devotes more space to the need for regulatory disciplines than to the market-opening objective. It insists on the "development of a . . . domestic regulatory commitment justified on the basis of specific public policy objectives," and it aims at further market opening "coupled, where necessary, with regulatory disciplines"—two strong statements not really counterbalanced by a quick reference to the development of more procompetitive regulations "where appropriate."

Moreover, the Commission makes a minimal reference to the horizontal (that is, nonsectoral) approach, which is largely counterbalanced by the emphasis on the need to take into account the "sensitivities" of specific sectors, and by the explicit reference to the "infrastructure" dimension of services for developing countries. Since Seattle, most public statements by the Commission have confirmed this insistence on regulatory convergence as a prerequisite for market access with one recent exception (see the conclusion of this chapter).[7]

If maintained, the EC approach based on regulatory convergence may be a source of conflict between certain key WTO trade partners (which are unprepared to compromise their own legal framework, but willing to accept regulatory competition) and EC member-states (which are accustomed to constrain their sovereign rights through regulatory convergence, particularly if it helps to slow down liberalization and to get a politically acceptable pace of adjustment).

It is important to note that the EC sectoral focus opposes two layers of EC joint competence—and hence will also be a source of *intra-EC* conflicts: the layer of the SMP-covered services, where the Community has some preeminence; and the layer of the services left outside the SMP, where member-states have preeminence and could use Article 53 (ex 64) as a safeguard clause (see above), particularly if they feel that the Commission or some member-states are using WTO negotiations to press for *intra-EC* liberalization. Coalition and coordination problems will not be minor for the EC, because the second layer of services consists of large, essential sectors (business services, construction, hospital services, retail and wholesale trade, tourism, etc.)—some of which have already attracted a lot of attention in the WTO forum, and which are politically very sensitive (some others have been explicitly excluded by the Nice Treaty from the majority rule).

Electronic commerce (hereafter e-commerce) offers a quintessential illustration of all the past, present, and future difficulties. This sector was not included in the initial list of SMP activities; in the Europe of the late 1980s and early 1990s, computers were yet too few and telecom prices too high to allow the Community to perceive the potential importance of this new technology. (At this time, the French Minitel experience had already reached its limits because of its hardware rigidity, its software deficiency, and its distorted price structure.) The Commission started to draft the e-commerce directive only in mid-1997. It tabled its final draft in late 1998, after many difficulties in making the new directive "consistent" with all the related "information society" directives on conditional access, distance selling, distance marketing of financial services, data protection, database transparency, etc.—revealing the complexity of injecting a new sector into the already tight web of SMP regulations inherited from 12 years of regulatory convergence.

7. See http://europa.eu.int/comm/trade/2000_round/seaserv.htm, April 2000, with the following excerpt: "Looking at individual sectors, the need for regulatory disciplines to underpin market access and national treatment appears increasingly important, and also includes the question of pro-competitive principles."

The draft directive was adopted by the Council in February 2000 and by the Parliament in May 2000. It is thus *expected* to become member-state law by the end of 2002—with the usual caveat about the long delays for transposing directives into member-state laws, a caveat amplified by the fact that by May 2000, none of the above directives closely related to e-commerce had been adopted by *all* the member-states, although most of them had been adopted at the Community level between 1995 and 1998.

Meanwhile, e-commerce has been emerging as a fascinating example of endless intra-EC and extra-EC barriers. For instance, German laws on promotional selling (Zugabeverordnung and Rabattgesetz, adopted in the 1930s, which prohibit—in conjunction with a main product to be sold—offering an additional product, because it would be an "unfair" gift) have been invoked to ban an unconditional guarantee for return of products sold through the Internet on the grounds that such a guarantee is a gift.[8] Another German law, which requires auctioneers to obtain a permit for each auction and to make a public exhibition of goods on the block, has been invoked in order to stop auctions on Internet sites.

In several member-states, publishers can dictate prices to bookshops on the ground and to domestic online ones, because of either a minimum retail price law, as in France, or a private sectoral agreement, as in Germany. These rules have a strong anticompetitive impact. They have forced domestic online bookshops to have several addresses in the EC (the same book in German can be 40 percent cheaper at the British address than at the German address of the same online bookshop). They also have induced Austrian online booksellers to supply discounted books in Germany (and similarly for Belgian booksellers in France). Reactions by vested interests have been swift: threats of retaliation by German publishers forcing Austrian online booksellers to come back to German prices (and triggering investigations by the EC competition authorities on private obstacles to intra-EC trade), and political pressure to impose minimum retail price laws in Austria and Belgium.

Despite this host of internal problems, the EC has not hesitated to push for regulatory convergence in e-commerce in international forums, and its call for new "competitive" rules for Internet service providers has made many corporate leaders in OECD countries nervous.[9] The currently most worrisome aspect of emerging EC policy on e-commerce is the classifica-

8. In July 1999, the Commission decided to refer Germany to the Court of Justice about this legislation, on the basis that it violates Article 49 (ex 59), and in April 2000, the company involved (Lands' End, a United States-based mail-order retailer) also lodged a complaint.

9. The Internet tends to challenge the creative capacities of regulators. It is often said to require new regulations in terms of taxation, tariffs, intellectual property rights, etc. (although, as recently suggested by the French Conseil d'Etat, such new regulations are not needed). Having Internet-specific regulations will run the risk of being self-destructive from a legal perspective. What may be needed are simply appropriate mechanisms to enforce the existing regulations affecting e-commerce transactions.

tion of transactions. Are movies (or music, software, stock exchange services, legal advice, etc.) that are sold through e-commerce goods or services? In a recent note,[10] the Commission has suggested rules that, if adopted by the WTO, would freeze protection at its highest current level, as is best illustrated by the movie case. The first option for buying a movie online is to order a cassette on the Internet and to get it physically delivered. According to the Commission, this option is to be decomposed into four different components: a good (the cassette), an Internet access service (the Internet gate), a telecom service (the telecom firm), and a distribution service (the online seller). The purchase of a movie cassette through e-commerce should thus comply with the combined commitments of the importing country on trade in cassettes (tariff), on the Internet, on telecoms, and on distribution services—hence, it will be limited by the *most* restrictive of all these commitments.

The second option for buying a movie considered by the Commission is the delivery of the movie in electronic form by downloading the film electronically under a pay-per-view regime. According to the Commission, the rules to be applied in this case should be those related to the content itself (in this example, the EC commitments in audiovisual services), not those related to the means of transmission (telecoms) nor to the good (the movie cassette). Clearly, such a rule would freeze at its highest current level the protection of the many services to be delivered through the Internet.[11] In other words, the current EC proposal wipes out the intrinsic e-commerce capacity to reduce the existing level of protection by its *mere* use (without the need for new negotiations).

By contrast (and contrary to its usual approach, which is to consider the SMP as a model for the WTO), the EC has not suggested importing into the WTO a very desirable feature of the SMP—namely, its ability to progressively focus on two modes of supply, cross-border and establishment. For instance, in the e-commerce case, it will be very difficult to allocate many transactions between cross-border trade and consumption abroad so that merging these two modes would constitute substantial progress for WTO negotiations in services (there would be no need for distinct, possibly inconsistent, commitments) and for a straight enforcement of market-access commitments.

To summarize, the Seattle Commission text suggests that the SMP may have already put serious constraints on the EC's approach in future WTO

10. See http://europa.eu.int/comm/trade/services/ecommerce/ecom2.htm, March 1999.

11. The Commission text raises two problems of logic. Why are imported recorded cassettes not subject today to service commitments? How would the electronic equivalent of buying a cassette (i.e., downloading the movie for a full purchase, instead of a pay-per-view) be treated? The logic of the Commission text (no difference because of different supports) suggests that the two purchases should be treated equivalently, i.e., they should be subject to the same tariff.

negotiations on services. One could argue that the 1997 WTO agreements on financial services and telecoms (for the success of which the EC has been instrumental) contradicts this conclusion. However, such a comparison is not so relevant, because these two agreements consist mostly of standstill provisions. In fact, there could be a much better argument for supporting the possibility of a positive EC role in the WTO negotiations in services: it is that the SMP has delivered an incomplete, reversible intra-EC liberalization, and that completing the SMP could be best achieved by WTO liberalization.

## Intra-EC Liberalization in Services: Incomplete and Reversible

Its focus on regulatory convergence has made the SMP so far unable to deliver a full and irreversible *internal* liberalization in services. In this respect, the SMP differs considerably from the Common Market in industrial goods, which has delivered much faster a much more complete, irreversible internal liberalization: *complete* because most intra-EC border barriers have been removed (see chapter 2); irreversible because member-states could not easily substitute new barriers for old ones (the intra-EC safeguard clause, Article 134 (ex 115), was tightly enforced by the Commission, which also monitored, though less strictly, technical barriers to trade—see chapter 4—and, even less strictly, subsidies, as shown below). What follows presents the main reasons for such an assessment, which is confirmed by the systematic empirical research summarized in box 5.2 and table 5.2.

In fact, the SMP in services has witnessed an irreversible liberalization only when technical progress has been a powerful procompetitive force—with, indeed, technical progress having been sometimes accelerated by the hopeless slowness of regulatory reforms in substitutable services, as best illustrated by mobile telephony, which has been all the more attractive because hopes of fast EC regulatory reforms in wired telephony have faded—and these procompetitive forces have had important spillovers on closely related services, from capital markets to distribution services.

Technical progress, however, is far from having always been a procompetitive force. For instance, the same huge progress in information technology has allowed airlines to improve their ability to design discriminatory prices in their protected markets more rapidly than it has allowed travelers to improve their ability to shop for cheaper prices—eroding severely the procompetitive potential of the "three packages" SMP in this sector (see appendix A, case 21).

Leaving aside the liberalization impact of technical progress, the SMP has had three basic kinds of very mixed results. First, the SMP has remained *incomplete*. Table 5.3 shows how many highly restrictive measures of protection have survived in every service covered by the SMP. Fiscal

## Box 5.2 The Single Market in services: Still to come

Recent research from the OECD Secretariat (Nicoletti 2000) allows a more quantitative assessment of how deeply the Single Market Program (SMP) has really bitten so far. On the basis of an international database on the regulations enforced in OECD countries (Nicoletti, Scarpetta, and Boylaud 2000), it provides indicators—from least (0) to most (6) restrictive—of the regulatory and market environment in 1998. Of course, such an exercise faces limits. Incomplete and imperfect information is a pervasive problem, and assessing the effect of regulations on the degree of competition is a matter of delicate judgment. However, statistical techniques (factor and cluster analyses) allow interesting comparisons between countries from this (admittedly imperfect) large set of information.

As shown in table 5.2, the seven services examined by the OECD research make it possible to account for the complexity of the SMP process: Two services (air passenger and road freight) were included early in the SMP (late 1980s); two others (mobile and fixed telephony) were incorporated late in the SMP (early 1990s); two others (electricity and railways) were covered by SMP extensions (mid- to late 1990s). Retail distribution is not part of the SMP.

Table 5.2 provides three major lessons. First, the EC does not appear, on average, more open than the rest of the OECD countries (defined as the OECD countries not pertaining and not candidate to the EC) in all these sectors. Second, the indicators for the various EC member-states do not show the similarity that would reveal a strong impact of the SMP; certain member-states are still among the most open markets in the OECD region, whereas others are still among the most closed ones. Third, these results are observed whether examined services have been subjected to the SMP or not, for a long time or not.

Table 5.2 shows that the countries that are candidates for accession to the EC will have to make huge efforts toward regulatory reforms of services. All these observations confirm the view presented in the main text, according to which the impact of the SMP is so far very limited—hence the large potential benefits that the EC could get from a WTO liberalization of services. Indeed, the fact that EC member-states exhibit an average (of the seven sectors) indicator more restrictive than the indicator of the rest of the OECD countries (last column on the right) suggests that the EC may gain more from a new round than most of its OECD partners.

The OECD studies provide additional results in three services for which it has been possible to generate an external liberalization element. In air and road transport, barriers to entry have been split into a component of public intervention in domestic markets and an element of discrimination against foreign providers. The EC exhibits a smaller indicator for foreign discrimination than the rest of the OECD countries only in air transport. However, this result (which mirrors SMP-related legal aspects, e.g., the definition of what an EC carrier is; see appendix A, case 21) is more than compensated for by a higher indicator for domestic entry barriers.

In telecoms, estimated price deviations from the OECD average have been decomposed for each country into several components, including a foreign discrimination element. This exercise presents the EC member-states as on average more homogeneous than suggested by table 5.2, and as less expensive than the rest of the OECD countries. However, this result is not related to the liberalization component but to an element (the country economic structure) that captures, among other factors, the impact of technology—echoing what is said in the main text on the role of technical progress in the SMP's apparent successes.

**Table 5.2 Regulatory and market environment in 1998** (the scale of indicators is 0–6, from least to most restrictive)

| | Air passenger transport | | | Road freight | | | Mobile telephony | | |
|---|---|---|---|---|---|---|---|---|---|
| | Overall indicator for the sector | Market structure indicator | Barriers to entry indicator | Overall indicator for the sector | Market structure indicator | Barriers to entry indicator | Overall indicator for the sector | Market structure indicator | Barriers to entry indicator |
| **European Community** | | | | | | | | | |
| Austria | 3.2 | 3.4 | 3.1 | 2.8 | 2.7 | 2.8 | 3.5 | 4.0 | 3.0 |
| Belgium | 4.4 | 5.5 | 3.3 | 3.2 | 3.0 | 3.3 | 3.8 | 4.5 | 3.0 |
| Britain | 2.2 | 1.1 | 3.3 | 1.3 | 2.4 | 0.6 | 0.0 | 0.0 | 0.0 |
| Denmark | 4.7 | 5.8 | 3.6 | n.a. | n.a. | n.a. | 3.4 | 3.9 | 3.0 |
| Finland | 3.6 | 3.4 | 3.8 | 1.7 | 3.6 | 0.6 | 2.3 | 4.6 | 0.0 |
| France | 3.2 | 2.3 | 4.1 | 2.5 | 2.2 | 2.6 | 0.8 | 1.7 | 0.0 |
| Germany | 3.0 | 2.6 | 3.4 | 3.0 | 2.7 | 3.2 | 3.2 | 3.5 | 3.0 |
| Greece | 5.5 | 5.8 | 5.1 | 3.6 | 4.0 | 3.4 | 2.4 | 1.7 | 3.0 |
| Ireland | 4.4 | 5.6 | 3.1 | n.a. | n.a. | n.a. | 3.7 | 4.4 | 3.0 |
| Italy | 3.3 | 2.8 | 3.8 | 4.6 | 4.1 | 4.9 | 2.2 | 4.5 | 0.0 |
| Netherlands | 2.7 | 2.8 | 2.6 | *2.4* | n.a. | n.a. | 2.2 | 4.4 | 0.0 |
| Portugal | 5.1 | 5.1 | 5.1 | 2.3 | 2.1 | 2.4 | 3.4 | 3.7 | 3.0 |
| Spain | 2.9 | 1.9 | 3.9 | 3.0 | 2.3 | 3.4 | 4.6 | 4.6 | 4.5 |
| Sweden | 3.3 | 3.2 | 3.4 | 2.2 | 2.6 | 2.0 | 1.8 | 3.7 | 0.0 |
| **Candidate countries** | | | | | | | | | |
| Czech Republic | 5.8 | 6.0 | 5.5 | 3.0 | 3.0 | 3.1 | 4.6 | 4.7 | 4.5 |
| Hungary | n.a. | n.a. | n.a. | 3.4 | 3.5 | 3.3 | 4.3 | 4.0 | 4.5 |
| Poland | 6.0 | 6.0 | 6.0 | 2.7 | 2.0 | 3.1 | n.a. | n.a. | n.a. |
| Turkey | 6.0 | 5.9 | 6.0 | *2.7* | n.a. | n.a. | 3.9 | 4.9 | 3.0 |
| **Rest of the OECD** | | | | | | | | | |
| Australia | 3.3 | 3.1 | 3.5 | *0.8* | n.a. | n.a. | 0.9 | 1.8 | 0.0 |
| Canada | 3.6 | 3.1 | 4.1 | 2.0 | 2.6 | 1.6 | n.a. | n.a. | n.a. |
| Japan | 3.1 | 1.5 | 4.7 | *2.1* | n.a. | n.a. | 0.4 | 0.8 | 0.0 |
| Korea | 3.8 | 3.2 | 4.4 | 1.1 | 0.5 | 1.4 | 1.6 | 3.1 | 0.0 |
| Mexico | 3.5 | 2.3 | 4.7 | 2.2 | 1.6 | 2.6 | 2.5 | 2.0 | 3.0 |
| New Zealand | 3.7 | 5.2 | 2.2 | 1.3 | 2.4 | 0.6 | 2.6 | 5.2 | 0.0 |
| Norway | 2.9 | 2.6 | 3.1 | 2.2 | 2.9 | 1.8 | 3.9 | 4.9 | 3.0 |
| Switzerland | 4.6 | 4.1 | 5.1 | *3.8* | n.a. | n.a. | 4.5 | 6.0 | 3.0 |
| United States | 1.2 | 0.4 | 2.0 | 1.5 | 1.5 | 1.5 | n.a. | n.a. | n.a. |
| **Averages** | | | | | | | | | |
| European Community | 3.7 | 3.6 | 3.7 | 2.7 | 2.9 | 2.7 | 2.7 | 3.5 | 1.8 |
| Rest of the OECD | 3.3 | 2.8 | 3.8 | 1.9 | 1.9 | 1.6 | 2.3 | 3.4 | 1.3 |
| Candidates | 5.9 | 6.0 | 5.8 | 2.9 | 2.8 | 3.2 | 4.3 | 4.5 | 4.0 |
| **Minima** | | | | | | | | | |
| European Community | 2.2 | 1.1 | 2.6 | 1.3 | 2.1 | 0.6 | 0.0 | 0.0 | 0.0 |
| Rest of the OECD | 1.2 | 0.4 | 2.0 | 0.8 | 0.5 | 0.6 | 0.4 | 0.8 | 0.0 |
| **Maxima** | | | | | | | | | |
| European Community | 5.5 | 5.8 | 5.1 | 4.6 | 4.1 | 4.9 | 4.6 | 4.6 | 4.5 |
| Rest of the OECD | 4.6 | 5.2 | 5.1 | 3.8 | 2.9 | 2.6 | 4.5 | 6.0 | 3.0 |

n.a. = not available.
OECD = Organization for Economic Cooperation and Development.

Note: Figures in italics are simple averages of minimum and maximum indicators.

*Sources:* Boylaud (2000), Boylaud and Nicoletti (2000), Gonenc and Nicoletti (2000), Gonenc, Maher, and Nicoletti (2000), Steiner (2000).

barriers in financial services, slot allocations in air transport, unconditional access to networks in telecoms, and quotas and licensing rules in audiovisuals, untouched in 1997, were still there in mid-2000, almost unchanged—although they may have taken different technical forms, such

| Fixed telephony | | | Electricity | | | Railways | | | Retail distribution | | | Average by country |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Overall indicator for the sector | Market structure indicator | Barriers to entry indicator | Overall indicator for the sector | Market structure indicator | Barriers to entry indicator | Overall indicator for the sector | Market structure indicator | Barriers to entry indicator | Overall indicator for the sector | Market structure indicator | Barriers to entry indicator | Simple averages of sectoral overall indicators by country |
| 3.0 | 6.0 | 0.0 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | 4.1 | 3.0 | 5.5 | 3.3 |
| 3.0 | 6.0 | 0.0 | 5.5 | 6.0 | 5.0 | 6.0 | 6.0 | 6.0 | 3.1 | 3.6 | 2.3 | 4.1 |
| 1.0 | 2.0 | 0.0 | 0.0 | 0.0 | 0.0 | 3.0 | 3.0 | 3.0 | 2.5 | 2.8 | 2.1 | 1.4 |
| 2.2 | 4.4 | 0.0 | 5.0 | 6.0 | 4.0 | n.a. | n.a. | n.a. | *2.9* | n.a. | n.a. | 3.6 |
| 0.4 | 0.9 | 0.0 | 0.0 | 0.0 | 0.0 | 6.0 | 6.0 | 6.0 | 3.0 | 2.9 | 3.0 | 2.4 |
| 3.0 | 6.0 | 0.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 4.7 | 4.5 | 5.0 | 3.7 |
| 3.0 | 6.0 | 0.0 | 2.1 | 1.5 | 2.7 | 3.0 | 6.0 | 0.0 | 1.2 | 1.3 | 1.2 | 2.6 |
| 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | n.a. | n.a. | n.a. | *3.8* | n.a. | n.a. | 4.5 |
| 2.8 | 5.5 | 0.0 | 4.5 | 3.0 | 6.0 | 6.0 | 6.0 | 6.0 | 1.4 | 1.6 | 1.0 | 3.8 |
| 3.0 | 6.0 | 0.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 3.1 | 3.3 | 2.8 | 4.0 |
| 2.9 | 5.7 | 0.0 | 5.3 | 4.5 | 6.0 | n.a. | n.a. | n.a. | 1.4 | 1.8 | 0.8 | 2.8 |
| 6.0 | 6.0 | 6.0 | 4.2 | 3.0 | 5.3 | n.a. | n.a. | n.a. | 2.6 | 2.5 | 2.8 | 3.9 |
| 3.0 | 6.0 | 0.0 | 3.8 | 3.0 | 4.7 | 4.5 | 3.0 | 6.0 | 2.5 | 2.8 | 2.0 | 3.5 |
| 1.7 | 3.4 | 0.0 | 0.8 | 1.5 | 0.0 | 3.0 | 3.0 | 3.0 | 1.7 | 1.7 | 1.6 | 2.1 |
| 6.0 | 6.0 | 6.0 | n.a. | n.a. | n.a. | 1.5 | 3.0 | 0.0 | 0.8 | 0.6 | 1.1 | 3.6 |
| 6.0 | 6.0 | 6.0 | n.a. | n.a. | n.a. | 3.0 | 6.0 | 0.0 | 1.9 | 1.5 | 2.4 | 3.7 |
| 6.0 | 6.0 | 6.0 | n.a. | n.a. | n.a. | 1.5 | 3.0 | 0.0 | 3.6 | 2.3 | 5.3 | 3.9 |
| 6.0 | 6.0 | 6.0 | n.a. | n.a. | n.a. | 6.0 | 6.0 | 6.0 | *3.0* | n.a. | n.a. | 4.6 |
| 1.3 | 2.6 | 0.0 | 0.9 | 1.5 | 0.3 | n.a. | n.a. | n.a. | 1.1 | 1.4 | 0.7 | 1.4 |
| 0.8 | 1.6 | 0.0 | 6.0 | 6.0 | 6.0 | 3.0 | 3.0 | 3.0 | 1.3 | 1.7 | 0.6 | 2.8 |
| 1.1 | 2.2 | 0.0 | 5.0 | 6.0 | 4.0 | 3.0 | 3.0 | 3.0 | *4.1* | n.a. | n.a. | 2.7 |
| 1.9 | 3.8 | 0.0 | n.a. | n.a. | n.a. | 6.0 | 6.0 | 6.0 | 1.3 | 0.9 | 1.9 | 2.6 |
| 1.7 | 3.3 | 0.0 | n.a. | n.a. | n.a. | 4.5 | 3.0 | 6.0 | 1.9 | 2.0 | 1.7 | 2.7 |
| 1.4 | 2.8 | 0.0 | 0.0 | 0.0 | 0.0 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | 1.8 |
| 3.0 | 6.0 | 0.0 | 0.0 | 0.0 | 0.0 | 4.5 | 3.0 | 6.0 | 2.2 | 3.0 | 1.1 | 2.7 |
| 3.0 | 6.0 | 0.0 | n.a. | n.a. | n.a. | 6.0 | 6.0 | 6.0 | 1.1 | 1.2 | 1.0 | 3.8 |
| 0.3 | 0.5 | 0.0 | 4.3 | 4.5 | 4.0 | 1.5 | 3.0 | 0.0 | n.a. | n.a. | n.a. | 1.7 |
| 2.9 | 5.0 | 0.9 | 3.8 | 3.6 | 4.0 | 4.8 | 5.0 | 4.7 | 2.7 | 2.7 | 2.5 | 3.3 |
| 1.6 | 3.2 | 0.0 | 2.7 | 3.0 | 2.4 | 4.1 | 3.9 | 4.3 | 1.9 | 1.7 | 1.2 | 2.5 |
| 6.0 | 6.0 | 6.0 | n.a. | n.a. | n.a. | 3.0 | 4.5 | 1.5 | 2.3 | 1.5 | 3.0 | 4.1 |
| 0.4 | 0.9 | 0.0 | 0.0 | 0.0 | 0.0 | 3.0 | 3.0 | 0.0 | 1.2 | 1.3 | 0.8 | 1.2 |
| 0.3 | 0.5 | 0.0 | 0.0 | 0.0 | 0.0 | 1.5 | 3.0 | 0.0 | 1.1 | 0.9 | 0.6 | 0.7 |
| 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 4.7 | 4.5 | 5.5 | 5.3 |
| 3.0 | 6.0 | 0.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 4.1 | 3.0 | 1.9 | 4.6 |

as the bundling of access in telecoms with specific conditions on mobile or Internet services.

The costs of the EC nonuniform approach to service liberalization have begun to emerge. The many severe entry barriers in sectors not covered by the SMP have reduced the scope and benefits to be expected from liberalization in the sectors that are covered by the SMP. For instance,

**Table 5.3 Removing barriers in the Single Market: The situation in 1997**

| Service | Cross-border service restrictions | Restrictions on establishment | Restrictions on factor flows | Regulatory and technical barriers | Fiscal barriers | Other barriers |
|---|---|---|---|---|---|---|
| Banking | ✓✓Discriminatory conditions for cross-border sale of services<br>✓Restrictions on marketing and service content | ✓✓Discriminatory conditions for licenses | ✓✓Capital controls | ✓✓Prudential requirements<br>✓Consumer protection | ✗Tax on savings<br>✗Investment income tax<br>✗Death duties | |
| Insurance | ✓✓Discriminatory conditions for cross-border sale of services<br>✓Restrictions on marketing and service content<br>✗Single license for brokers | ✓✓Discriminatory conditions for licenses | ✓✓Capital controls | ✓Consumer protection conditions for sales | ✗Taxation of reserves<br>✗Taxation of premiums | |
| Road freight transport | ✓✓Bilateral quota restrictions on access to other EC markets<br>✓✓Price restrictions | ✓✓Discriminatory licensing conditions | ✓Cabotage restrictions<br>✓✓Recognition of diplomas | ✓✓Weights and dimensions<br>✓Road safety rules<br>✓Speed limiters<br>✓Resting hours | ✓✓Excise duties | ✓✓Border formalities for goods |
| Air transport | ✓✓Bilateral restrictions on free access to other EC markets<br>✓✓Price restrictions<br>✗Slots allocation | ✓✓Exclusive rights for licensing of air carriers<br>✗Ownership rules in third-country bilateral agreements | ✓Cabotage restrictions<br>✓✓Designation and capacity restrictions | ✓✓Conditions for sales<br>✓✓Security and safety rules<br>✗Airport charges | ✓Value-added tax | ✓Border formalities for passengers<br>✓✓Access to computer reservation systems<br>✓State aid, unfair practices |

| | | | | | | |
|---|---|---|---|---|---|---|
| Telecom liberalized services | ✓Discriminatory conditions for access to network | ✓✓Exclusive rights on mobile, data, and satellite services | ✓✓Exclusive rights to sell equipment | ✓Technical conditions for use of networks | | ✗Fair access to networks |
| Television broadcasting services | ✓✓Restrictions on cross-frontier broadcasting<br>✓Rental and lending rights<br>✓Term of copyright protection<br>✓Copyright applicable to satellite and cable | ✗National licensing rules for broadcasters<br>✗Media ownership restrictions<br>✗National quotas on programs | | ✓Technical conditions for use of networks | | ✓✓Border formalities for goods<br>✓Technical barriers on products |
| Distribution (fast-moving consumer goods) | No restrictions | No restrictions | ✓✓Restrictions on free movement of goods | | ✓Value-added tax | ✓✓Border formalities for goods |
| Advertising | ✗Types of products and media<br>✗Comparative advertising | No restrictions | ✓Restrictions on media | ✓Misleading advertising<br>✗Content restrictions | | |

✓✓ Barriers effectively removed.
✓ Barriers partially removed.
✗ Remaining barriers.

*Source:* European Commission (1996).

restricted entry in retail permits member-state markets of goods to be more segmented than they would be with more competition among retailers, and it has a similar, probably stronger, impact in services, such as banking or transport services; the absence of competition between travel agencies from different member-states contributes to market segmentation and limited competition in air transport; a similar observation can be made about hospital service providers and pharmaceutical markets.

Second, the SMP's implementation has witnessed a *partial reversal* of the liberalization process because of three major forces not observed (at least, to such an extent) in the case of the Common Market in manufactured goods. The first force is that subsidies have been and still are substantial in services (see table 5.4, despite the fact that they are probably recorded with less accuracy), and more frequently granted to public monopolies or firms with "special" rights, as is best illustrated by the €3.3 billion subsidy to Air France (see appendix A, case 21), the €3 billion subsidy to Westdeutsche LandesBank (WestLB)—and, last but not least, the (at least) €20 billion state aid to Crédit Lyonnais, the largest subsidy ever granted to one firm in the EC (alone, it is equivalent to two-thirds of all the state aid granted to the entire EC steel industry during the peak crisis years 1980–85).[12] Moreover, the devolution of the antisubsidy policy in service sectors to the Directorates General in charge of the services involved (in sharp contrast with the antisubsidy policy for goods, which is handled only by the Directorate for Competition) has severely amplified the problems of subsidy monitoring (see the section below on competition policy).

The second force leading to reversals of liberalization is that member-states have been quick to adopt new protectionist measures, often relying on the ambiguities entrenched in the EC directives by the process of regulatory convergence. For instance, joint pressures by governments and competitors have curbed entrant efforts to offer new services (current accounts bearing interest in France, units of closed-end investment funds in Germany) or they have denied access to essential facilities during strategic periods (slots in airports, access to networks, etc.).

The use, or threat of use, of taxes has been another way to deter entrance. Tax equivalents on new entrants have been imposed through extensive interpretations of the "universal service" notion in telecoms (in France, imposing a tax of roughly €665 million in 1998, €435 million

12. Assessing the effective impact of these subsidies is difficult because service sectors are also riddled with taxes of all kinds (e.g., certain European airlines might have been indirectly taxed through the obligation to buy Airbus aircraft at prices that reportedly have been higher than prices paid by non-EC airlines). Unfortunately, there is no study giving a sense of the corresponding effective rates of protection.

## Table 5.4 Annual average national and EC subsidies, 1990–98

| | 1990–92 | 1992–94 | 1993–95 | 1995–98 |
|---|---|---|---|---|
| **National state aid** | | | | |
| (in millions of euros)[a] | | | | |
| Agriculture | n.a. | n.a. | 10,772 | 13,339 |
| Fisheries | 320 | 356 | 333 | 260 |
| Coal mining | 14,773 | 13,792 | 11,487 | 7,227 |
| Manufacturing | 39,784 | 41,439 | 42,882 | 32,639 |
| Transport | n.a. | 32,375 | 34,843 | 32,193 |
| Financial services | n.a. | n.a. | 1,147 | 3,283 |
| Total[b] | n.a. | 97,962 | 10,1464 | 93,127 |
| **EC subsidies** | | | | |
| (in millions of euros)[a] | | | | |
| Agriculture | 32,362 | 36,212 | 37,382 | 43,631 |
| Fisheries | 320 | 417 | 442 | 486 |
| Social fund | 4,728 | 6,009 | 5,151 | 7,846 |
| Regional fund[c] | 1,101 | 2,743 | 3,631 | 5,168 |
| Research and development | 1,853 | 2,168 | 2,366 | 3,379 |
| Steel grants | 459 | 465 | 398 | 179 |
| Total | 40,823 | 48,014 | 49,369 | 60,688 |
| **National and EC subsidies** | | | | |
| (in millions of euros) | | | | |
| Total | n.a. | 145,976 | 150,833 | 153,815 |
| **State aid to manufacturing sector** | | | | |
| (in percent of value-added) | | | | |
| Austria | — | — | — | 1.4 |
| Belgium | 7.9 | 4.8 | 2.5 | 1.9 |
| Britain | 1.4 | 0.8 | 0.8 | 0.7 |
| Denmark | 1.9 | 2.8 | 2.7 | 2.9 |
| Finland | — | — | — | 1.6 |
| France | 2.7 | 3.3 | 2.1 | 2.0 |
| Germany | 3.5 | 4.8 | 4.4 | 2.6 |
| Greece | 12.5 | 10.5 | 5.2 | 4.9 |
| Ireland | 2.7 | 3.5 | 2.4 | 1.9 |
| Italy | 8.9 | 8.4 | 6.1 | 4.4 |
| Luxembourg | 3.5 | 2.9 | 2.2 | 2.3 |
| Netherlands | 2.5 | 2.1 | 1.1 | 1.1 |
| Portugal | 4.6 | 4.4 | 2.7 | 1.0 |
| Spain | 2.1 | 1.7 | 2.1 | 2.1 |
| Sweden | — | — | — | 0.8 |
| EC[b] | 3.8 | 4.0 | 3.5 | 2.3 |

n.a. = not available
EC = European Community.

a. For EC-12 for the period 1990–95, EC-15 for 1995–98.
b. The total includes a series of small subsidies not reported.
c. Includes the Cohesion Fund after 1993.

*Sources:* European Commission, *Surveys on State Aids*, various issues.

in 1999, and €427 million in 2000),[13] or of the "general interest" notion in certain financial services (European Commission 1999f). Income tax advantages granted to certain insurance contracts in 1998 (France) or available to issuers whose securities are quoted for the first time on regulated markets (Italy) favored domestic stock markets over competitors. And Belgian local taxes imposed on satellite dishes on alleged aesthetic grounds (mostly in the Wallonia region) have severely limited entry of audiovisual service providers willing to compete with incumbent TV networks.

Last but not least, the third force leading to reversals of liberalization is that private barriers have also been rapidly erected by incumbents immersed in the collusive mentality prevailing in Europe (Amatori 1999). For instance, European banks have been found to charge fees of on average 17 percent on small-value cross-border transfers in euros (domestic transfers are charged an average 1 percent fee)—inhibiting the deepening of the euro market.[14] There is little doubt that route sharing in air transport allows further restriction of arbitrage between markets and amplifies price discrimination, to the detriment of travelers.

The impact of all these public and private barriers has been amplified by the SMP focus on "commercial presence"—and its correlative neglect of "cross-border" trade. The so-called EC passport (the possibility for a firm to operate in other EC countries from its home member-state) has been shown to not be enough to get rid of markets still segmented by border barriers. Indeed, direct investment has been seen by many incumbents as having the capacity to raise rivals' costs more (or more easily) than cross-border trade. This implicit anticompetitive feature of commercial presence may explain the strong support that it has received from European incumbent service providers (often among the largest firms in the early 1990s) during the drafting of the SMP directives in services.[15]

13. See Autorité de Régulation des Télécommunications, http://www.art-telecom.fr

14. See http://europa.eu.int/comm/internal_market/en/finances/payment/2k-505.htm. Such fees also violate the ban on double charging imposed by the Cross-frontier Transfer Directive.

15. The crucial balance between commercial presence and cross-border trade is best illustrated by the retail industry. In the 1970s and early 1980s, most EC member-states adopted regulations limiting the creation of large stores and the legal range of shop opening hours. These regulations had nothing to do with international competition (then almost nonexistent). They intended to face a purely domestic issue: to protect small domestic "mom-and-pop" shops against large domestic firms, with no discriminatory intent against foreign firms. Twenty years later, these regulations have deeply distorted the prices of commercial land, as much as the Common Agricultural Policy has distorted the prices of farmland. Eliminating such regulations will not eliminate land price distortions in one magical stroke, nor the existing geographical misallocation of large stores (with overcapacities in some regions, cities, or even urban districts), which has been one of the many perverse consequences of protecting small shops. Under such conditions, competing through commercial presence requires large investments and a long-term strategy. For example, the largest US retailer, Wal-Mart, had to pay €10 billion to buy the British supermarket chain Asda in early 1999

The third and final mixed result of the SMP is that Community initiatives for harmonization, such as new EC-wide taxes, have also contributed to the reversal of the liberalization process by reducing or eliminating its expected benefits. For instance, environmental and other taxes have been part of the harmonization package in road transport. The swift imposition of these taxes during the SMP liberalization process in road transport has transformed the estimated 4 percent cost decrease due to liberalization measures into an estimated 4 percent cost increase—generating wide differences between EC member-states, because costs have been estimated to increase by more than 7 percent in Spain, but by less than 3 percent in Denmark and Germany (*Single Market Review* 1997b).

It is sometimes argued that dealing with such barriers could be done through competition cases, but this is a slow and uncertain process, particularly if it requires going to the Court of Justice. Moreover, lawsuits can also be launched by incumbents in their own member-state, in order to slow down the liberalization process—a tactic particularly successful when the breakup of the former monopoly was not guaranteed by clear enough rules, when the new regulators were insufficiently separated from incumbents, or when old laws imposed insurmountable constraints on new technologies (see the e-commerce discussion above).

## The SMP in Services Needs WTO Liberalization

As is well known, country schedules of General Agreement on Trade in Services (GATS) commitments do not provide good information on external barriers in services. For instance, the EC GATS schedule does not mention large-store or opening-hours regulations as barriers to retail trade. Ironically, the dispute settlement case on bananas was lost by the EC partly because there was no EC reservation on wholesale trade that could have been used as a legal basis for the banana distribution quotas. However, one can reasonably assume that these barriers are still high, as is suggested by the crude sectoral estimates provided in chapter 2, and indirectly confirmed by the studies summarized in box 5.2.

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and become a sizable player in Britain able to launch a significant price war. By contrast, despite its €1.7 billion purchase of a large German retail firm (Wertkauf), Wal-Mart is not expected to become a sizable player in the German retail industry for a decade (Deutsche Morgan Grenfell 1998), all the more because another large European retailer (Metro) reacted immediately to Wal-Mart's entry by purchasing another large German retailer, leaving Wal-Mart with very few additional possible purchases. It is interesting to note that, in September 2000, the German Federal Cartel Office accused Wal-Mart of inciting a price war in which it (and two German supermarket chains) had illegally sold products at below their wholesale costs. Following this relatively unusual accusation of "unfair" tactics, the Cartel Office ordered the three retailers to raise their prices on a series of products such as milk, flour, butter, rice, and cooking oil ("Germany Tells Wal-Mart to Raise the Price of Food," *International Herald Tribune*, 9 September 2000, 11).

This conclusion strongly suggests that the SMP would greatly benefit from WTO negotiations in services. In fact, this has already been modestly the case; the 1997 WTO Telecom Agreement has helped the EC to eliminate or reduce transitory periods that the least-developed EC member-states were able to extract during the negotiations on the intra-EC SMP in basic telephony.

Despite the large benefits that the SMP could get from the new WTO round, the EC could be reluctant to enter into rapid negotiations because it would be under the pressure of the following argument: during the past decade, EC firms in services have appeared increasingly small in comparison with their foreign (particularly US) competitors. The diminishing relative size of EC firms would make them less and less able to benefit from scale or scope economies, to innovate at the level required by competition, or to spread risks over a large enough portfolio of activities. As a result, EC vested interests may argue for a need for "consolidation" at the European level *before* opening EC markets to foreign competition. Before the Tokyo Round, this argument was made, with some success, for the manufacturing sector (Servan-Schreiber 1967), and it could be reused—despite the fact that the experience of the Common Market in goods suggests that intra-EC mergers and acquisitions (M&As) are not the necessary intermediate step before worldwide M&As—rather, it suggests that EC firms following a well-conceived worldwide strategy become, *on the top of it*, large EC firms.

The strength of this argument will depend on the evolution of the M&As involving European firms during the coming decade. Many EC service providers were small in the 1980s because they were often operating in segmented member-state markets. Firms based in large EC economies, however, could still be relatively large, particularly if they were monopolies or duopolies. But from the mid-1980s to the late 1990s things dramatically changed in many service sectors. US M&As have generally covered the entire US market. By contrast, European M&As have been largely limited to *intra-member-state* operations; more than 70 percent of the M&As between 1990 and 1995 were still intra-member-state operations (roughly the same level as during the period 1986–90), whereas *intra-EC* M&As increased only from 16 to 19 percent (Buigues and Sapir 1999).[16]

It may be argued that this evolution is not surprising because during this time, the SMP was only in its drafting period. Moreover, intra-EC M&As in SMP sectors have been almost openly discouraged by member-states (e.g., the first merger between a French bank and an EC bank was announced in April 2000, and it involved Crédit Commercial de France, which is only the seventh largest French bank) when they have not been inhibited systematically by tax regimes (as is best illustrated by the Ger-

16. It is interesting to note that member-state-based M&As tend to increase the risks and costs of asymmetrical shocks under monetary union for these implicit "national" champions.

man 50 percent tax on capital gains, which makes it very expensive for German banks or insurance companies to streamline their portfolios). Governmental disincentives, combined with the collusive mentality still largely prevailing in the Europe of the 1990s and weak anticartel enforcement in Europe (see below), have led EC firms from different member-states to form "alliances" aimed at consolidating national market shares. But such alliances have rapidly shown their limits, particularly their intrinsic instability (as is best illustrated by the many failed attempts to build such alliances in the audiovisual sector; see appendix A, case 22).

However, in 1999, with the first signs in 1997–98, things may have begun to change. The value of European M&As in 1999 was estimated to be $1,500 billion (three times the 1997 value); large deals (of more than $10 billion) represented roughly $700 billion (seven times the 1997 amount), and there were 393 hostile bids (compared with 7 in 1997) (JP Morgan, as reported in *The Economist*, 29 April 2000, Survey, 10). However, the list of motives behind these deals ranks technical progress first (most of these deals were done in sectors under strong technological pressures, as in telecoms) ranks the emergence of the euro (more precisely, its microeconomic impact at the level of competitive pressures in EC markets) second, ranks the privatization process third, and ranks the SMP process *fourth* and last.

Before being qualified as landmark progress, the 1997–99 evolution in European M&As raises four questions. First, will it continue, or will member-states renew their efforts to tilt it toward "national" champions? Second, will firms continue to use M&As more as a consolidation process in their domestic markets than as an instrument for access to new markets? Third, will European M&As be less successful than US M&As because they must face an environment more hostile to changes in labor and capital markets (as is illustrated by the painful reengineering of Hoechst)? And fourth, what will the impact of M&As be on competition in the still very segmented EC markets?

This fourth question is essential. Many of the recent large M&As have been among utilities (often closely tied to member-state governments), public monopolies, public firms to be privatized, or freshly privatized public monopolies, as is best illustrated by deals such as those between VEBA-VIAG and Tractebel-Suez-Lyonnaise des Eaux, EDF and EnBW-Hidroelectrica del Cantabrio, and Deutsche Post and Lufthansa. In other words, current European M&As are much more about market consolidation than about competition in European markets, more so because some of the biggest service firms in member-states have become so powerful at home that they have little choice but to look abroad. Taking into account the history of the EC service sectors, this situation may be inescapable in the medium term, but it sheds some doubts on the expected success rate for these M&As: it could be lower than the corresponding rate (50 percent) in a fully fledged single market, like the United States. And this concentration movement clearly imposes renewed efforts to boost the procompetitive impact of the SMP. This context should make WTO negotiations on service liberalization all the more attractive to the EC.

## Trade and Labor Issues

The Commission devotes more space in its Seattle Communication to the topic of trade and labor than to any other issue, as does the Council—but paradoxically not the Parliament, which devotes more space to services, with a marked antiliberalization tone. However, all these long texts on trade and labor leave the general impression that the EC is unwilling to move very far on this touchy topic—echoing the EC's "follower" behavior on this issue at the very end of the Uruguay Round negotiations, when even the most vocal member-states (Belgium, France, and Germany) were ultimately unprepared to go beyond rhetoric.

The Commission text begins by taking note of the EC's failed attempt to create a working group on these matters during the 1996 Singapore WTO Ministerial. It praises the International Labor Organization (ILO) for the work it has done since then (in particular, the adoption of the Declaration on Fundamental Principles and Rights at Work in June 1998), and it recognizes that the ILO is the "body best placed to make real progress in this area"—and that trade and labor issues could easily be used for protectionist purposes. The Commission states that "there is no realistic prospect of consensus for the establishment of a working group within the WTO." Rather, it develops a strategy to be pursued "in parallel" with the new round, which would essentially consist of enhancing cooperation between the WTO and ILO (starting with a WTO-ILO high-level meeting on trade, globalization, and labor issues), and of granting extra benefits (under the Generalized System of Preferences schemes) to developing countries meeting core ILO conventions on labor. The Council text goes even further: it stresses the EC's "firm opposition to any sanctions-based approaches," a clear allusion to the stance of US President Clinton's administration toward the Seattle Ministerial.

The EC's position is not accidental, for three intertwined reasons. First, the Treaty of Rome contains no provision connecting trade and labor issues *within* the Single Market, an approach carefully followed since then as is last illustrated by the new version of Article 137 (ex 118) included in the Nice TEC version, which "excludes any harmonization of the laws and regulations of the member-states" on social matters and which reaffirms the "right of Member-states to define the fundamental principles of their social security systems." Second, in contrast with the WTO texts, the Treaty of Rome recognizes the fundamental right of free movement of labor—a right aiming to interconnect labor markets directly. Third, the

Treaty's approach has been (although to a limited extent) extended to countries closely linked to the EC through international treaties (e.g., Turkey, with the EC-Turkey Agreement, as discussed by the Court of Justice in the 1987 *Demirel* and 1989 *Sevince* cases). For these reasons, it will probably last during the coming round.

## EC's Long History of Disconnecting Trade and Labor Issues

Until the late 1980s—hence, during the first 30 years of the Community—raising trade and labor issues within the EC was a nonstarter. Intra-EC trade liberalization was seen as perfectly compatible with nonharmonized member-state labor and social regimes—in sharp contrast with the strong demand for EC harmonization of technical regulations in *product* markets (see chapter 4).

This situation was the consequence of the hot, lengthy debates during the negotiations for the Treaty of Rome. Between 1950 and 1956, Belgium and France opposed Germany on all the issues raised today about trade and labor, from working conditions to wage and social transfer matters. They insisted on the harmonization of labor conditions, wages, and social transfers as a prerequisite for a customs union, whereas Germany argued that such a total or partial harmonization on labor issues would be a recipe for failure, and thus should not be incorporated into the Treaty (Milward 1992; Bean et al. 1998). Fortunately, German views prevailed—ironically, they were based on the "social market economy" notion, which was used by the EC Parliament text released for Seattle to link trade and core labor standards.

As a result, the Treaty of Rome makes no reference whatsoever to *direct* links between trade and labor issues; by insisting on the close *cooperation* between member-states in labor matters, this makes the Treaty impermeable to the notion of using trade sanctions to impose labor standards. The Treaty Preamble and Article 2 make clear that the Community's goal is to raise the standard of living—intra-EC trade and the free movement of labor being two mechanisms to reach this objective. This approach left the initial version of the Treaty with a narrow legal basis on labor issues. The six initial articles (ex 117 to ex 122) on "social provisions" stated objectives that few governments could envisage refusing to sign: improving working conditions, equal pay for men and women, paid holiday regimes, and so on. Some of these objectives were included to grandfather the *principles* of such rights that preexisted in certain member-states. (For instance, the principle of equal pay for equal work was included in the French Constitution before the signing of the Treaty of Rome.) The Commission's efforts to introduce pieces of European social policy during the 1970s on this narrow Treaty basis were insignificant or failed.

In the mid-1980s, things *seemed* to change dramatically. In December 1989, a Charter on the Fundamental Social Rights for Workers (the so-called Social Charter) was tabled by the Commission, and adopted by all EC member-states except Britain. In 1992, it was annexed as Protocol No. 14 on Social Policy to the Maastricht TEC version (Britain was opposed to its introduction into the Treaty itself). In 1997, it was fully incorporated into the Amsterdam TEC version.[17] Meanwhile, the Commission tabled initiatives (the so-called Social Action Programs) in 1989, 1992, and 1995 on a wide range of topics—from uncontroversial training programs to controversial harmonization of national schemes to inform and consult workers. These Action Programs led to the adoption of 52 directives (as of January 1998), under the majority rule (hence applicable to Britain, although not necessarily voted by this member-state), and presented as the embryo of EC social policy.

However, the real impact of these apparently impressive changes is very limited, for four reasons. First, the Social Charter was a mere declaratory statement. Its introduction into the Amsterdam TEC version did not produce very much. It reaffirmed goals that had been present since 1958, such as health and safety in the workplace, plus a couple of general principles on gender equality and paid holidays. And it restated that the Community shall "support and complement" the social activities of member-states, and that unanimity remains the voting rule for the key aspects of social policy, such as social security and protection of workers. As already mentioned, the Nice TEC version of Article 137 (ex 118) reaffirms EC member-state sovereignty in social security matters, with a quite cryptic addition on the "modernization of social protection systems".

Second, the adopted EC directives are less stringent than existing national laws—a feature reflecting the unchanged Treaty obligation that EC rules should state only *minimum* requirements, if any (Article 137 [ex 118]). For instance, the 1993 directive imposed a maximum work week of 48 hours at a time when the effective average work week in member-states varied from 38 to less than 44 hours. As a result, EC "social" directives have almost no impact on actual practices in member-states. This negligible impact is mirrored by the modest funds allocated to the European Social and Cohesion Funds (see table 5.4): 11 percent of EC state aid, or less than 0.1

17. The Charter of Fundamental Rights adopted by the Intergovernmental Conference of Nice (2000) has little to do with labor issues. It is a declaratory statement about "people's rights" in general that is not included in the TEC. Its only provision interesting from a trade and labor perspective is Article 32, which prohibits child labor and protects young people at work. However, the ban on child labor is defined in loose terms, e.g., on the basis of the minimum school-leaving age ("the minimum age of admission to employment may not be lower than the minimum school-leaving age"); this condition is easy to circumvent, and may even be counterproductive (it could induce countries to set a low age for leaving school).

percent of the EC GDP (compared to the GDP share of social protection expenditure in member-states, which ranges from 15 to 35 percent).

Third, the controversial initiatives included in the Social Action Programs have not been adopted, or they have been curbed by subsequent or even concomitant measures adopted by member-states or by the Community itself. For instance, the attempt to harmonize schemes to inform and consult workers was abandoned in 1998, and the use of Article 141 (ex 119) for "retroactive" claims on equal pay (made possible by the 1990 *Barber* ruling of the EC Court of Justice) was severely limited by Protocol No. 2 of the Maastricht TEC version (the very same version that included the "Social Charter" as Protocol 14).

Fourth, adopted "social" directives are raising persistent or recurrent difficulties of transposition in most member-states—from Britain to France. In mid-2000, one-fourth of the social directives (12 out of 49) were still not transposed in all member-states, Spain being the only state having transposed all of them. Social directives account for only 4 percent of the total number of directives constituting the *acquis communautaire*, but they represent 5 percent of directives under consultation for member-state infringement, and 18 percent of directives for which the Court of Justice imposed fines for infringement between 1997 and 2000.[18]

In sum, social policy and transfers are always and in all cases a matter for member-states—an EC tradition to which Germany referred to justify its option of "renationalizing" direct aid to agriculture at the 1999 Berlin Council. Moreover, for five other reasons, the EC is unprepared and unwilling to go very far on trade and labor issues in the WTO forum.

First, the EC's evolution since 1958 has given a lot of ammunition to those who believe that increased trade and integration are powerful instruments for "catching up" (the argument behind the German position during the negotiations for the Treaty of Rome). Labor costs, which were lower in Germany than in France in the early 1950s, during the Treaty negotiations, have been higher since the late 1960s. Contrary to a frequent perception, since its origin the EC has included large "poor" regions (those with an income lower than 75 percent of the EC average); already in 1958, poor regions represented 11 to 15 percent of the EC's population,

18. Source: http://europa.eu.int/comm/secretariat_general/sgb/infringements/index_en.htm, dated 1 April 2000. The global figure of 18 percent could be split between 12 percent on access to public employment against Greece and Luxembourg, and 6 percent on night work of women against France. Of course, night work of women did exist in France before the EC directive in question (6 night workers out of 10 in the French health sector are women). But it was introduced through a long series of "exceptions" to the 1892 general ban—another illustration of the tortuous ways often used in Continental Europe for circumventing apparently generous labor laws (see below).

compared to 19 percent in the late 1980s. And the EC has shown its capacity to integrate these poor regions without interfering with trade.[19]

Second, the debate on trade and labor issues reemerged in the EC in the late 1980s, a few years after the 1986 accessions of Portugal and Spain and concomitantly with the Uruguay Round final negotiations. As a result, debates in Europe on social dumping (i.e., plants displaced from EC higher-wage member-states to lower-wage locations) have made little difference, if any, between "low-wage" member-states and "low-wage" non-EC countries. In these conditions, linking trade and labor issues in the WTO forum has an immediate boomerang effect on *intra-EC* relations: It is difficult to argue simultaneously that competition with workers in low-wage non-EC countries is unfair, and that competition with low-wage member-states is fair, all the more because the most frequently targeted low-wage non-EC countries (South Korea, Taiwan, etc.) have higher wages than some low-wage member-states. The boomerang effect is certain because some member-states have the world's most expensive labor forces. After all, viewed from (Western) Germany, France is a low-wage, low-labor-standards country.

Third, the fact that the protectionist dynamics of the trade and labor issues in the WTO forum can very easily engulf intra-EC trade will be magnified by the prospect of the accession of low-wage Central European countries. Indeed, the usual argument that closer integration between a richer and a poorer country may increase inequality in the richer country (by adversely affecting the incomes of its poorer citizens in relative, or even possibly absolute, terms) seems weaker in the case of Central Europe, for several reasons. Most Central European economies are very small relative to the EC economy (meaning that their impact on the huge EC economy will be minute), those likely to be the first to join the EC are growing rapidly, and the accession process for all the CECs will be spread over a long period (probably two decades). As one can easily expect, the CECs themselves are strongly opposed to any direct link between trade and labor issues in the WTO context *before* their accession to the EC—as is illustrated by the CEC opposition led by Hungary to the US and EC proposals on trade and labor issues during the preparatory meetings for the Seattle WTO Ministerial.

Fourth, there is an increasing recognition in European public opinion that Continental Europe is not the realm of "equality" it claims to be. A half-century of welfare state in Continental Europe has left so many visi-

19. In 1986, the GDPs per capita of Ireland, Portugal, and Spain were 64 percent, 29 percent, and 52 percent, respectively, of the average income per capita of the four largest member-states (Britain, France, Germany, and Italy). In 1999, they were 107 percent, 50 percent, and 67 percent, respectively. However, it remains to allocate these successes among three possible causes—domestic policies, EC influences, and worldwide influences. For a more detailed analysis at the regional level, see Neven and Gouyette (1995).

ble inequalities (in wages, unemployment, occupation, gender, etc.) that there is a relatively large consensus for not seeing trade as the appropriate instrument for action. In fact, low-wage member-states are not the least regulated in labor matters; the OECD index of stringency of employment protection laws is higher in Italy (142) and Portugal (125) than in Germany (120), and in Spain (112) than in France (95) or Denmark (32) (OECD 1994).

For all these reasons, the 1990s slowly made member-states *and* the Commission, initially prone to adopt European social regulations in order to expand its powers, more aware of the costs of these regulations for the workers themselves. The regulations, which were originally meant to protect the poor, consist of provisions that ultimately boost the income of *insiders* (those already employed). The wide acknowledgment of the limits of the welfare state has been reinforced by the fact that during the past decade, EC Continental member-states have developed tortuous ways to make their national labor markets more flexible—with workers realizing progressively how opaque and unfair to entrants or to reentrants into the labor market this flexibility has been (Cohen, Lefranc, and Saint-Paul 1997).

The fifth and last reason for the EC's inability to go very far with trade and labor issues in the WTO forum is the EC environment itself. For instance, a firm may decide to close its plant in a low-wage member-state, and to keep its plant in a high-wage state because redundancy costs are higher in the latter—illustrating the case where the rigid social policy of the high-wage state works as a beggar-my-neighbor policy. Comparing member-states and non-EC countries is also instructive. For instance, if the inequality gap is 60 percent higher in the United States than in France when measured in terms of current wages (i.e., wages earned by employed workers), it dramatically drops to 15 percent when current wages are adjusted (as they should be) for the likelihood of a worker being unemployed *and* the length of unemployment over the working life (Cohen et al. 1997). Of course, such evidence does not stop politicians in an individual member-state, as is illustrated by the recent mandatory reduction in the number of working hours per week in France. But it is difficult for such politicians to make their views prevail simultaneously in such a diverse group as the EC member-states, all the more because they implement different labor and social policies that rely on different instruments, and combine them differently.[20]

20. This point is crucial, because labor relations are a political topic by essence. For instance, one could easily argue that a minimum-wage regime prevails all over Continental Europe. But the fact that it is an essential instrument of public relations for the French government and an essential aspect of power devolution in Germany makes almost impossible a communitarization of this measure.

## The Single Market: Free Movement of Labor

The Treaty of Rome considers barriers to factor (labor and capital) movements as "trade" barriers. In this context, Article 39 (ex 48) of the Treaty establishes the "freedom of movement of workers" as one of the four pillars of the Single Market (one of the four "freedoms," in EC parlance)—an approach in complete opposition to the WTO framework. This Treaty provision had little impact until the 1995 *Bosman* ruling of the Court of Justice, and its long case law, which gave a precise definition of the direct applicability of Article 39 (ex 48) and a wide definition of the freedom of movement of workers. Moreover, Article 39 (ex 48) triggered several competitive forces, which in the long run will counterbalance the negative effects of EC social policy on labor markets.

The first competitive force flows from the above-mentioned large set of EC directives (63, as of January 1998) aiming to improve *skilled* labor mobility between member-states in accordance with Article 39 (ex 48). The directives are based on mutual recognition of member-state diplomas, conditional on the harmonization of the minimum knowledge judged necessary to provide certain services. By reducing barriers on skilled labor flows, these directives change the available supply of skilled labor in each member-state market—hence, the real impact of EC labor market regulations. The acceptance of diploma is significant in certain professions (e.g., doctors, nurses, veterinarians, teachers, and architects), and in member-states that are ready to import foreign skilled workers (e.g., Belgium, Germany, and Britain) or to export domestic skilled workers (e.g., Netherlands, Sweden, and Britain) (European Commission 1999f).[21]

It should be underlined that this first competitive force is antagonistic to the logic of the Social Plans and their related regulations, which require that workers employed in another member-state should receive *host* (*not* home) country terms and conditions of work—hence slowing down forces in favor of labor mobility. The limits imposed on "competition" between member-state social policies by the host country principle flow from the implicit assumption frequent in the EC that the home country principle would induce member-states to follow a "race to the bottom" policy reducing the social benefits of their workers. It is beyond the scope of this book to fully examine such an argument. But in these respects, the EC experience echoes the major lessons provided by the recent theoretical and

21. It is hard to get detailed evidence on these skilled labor flows. E.g., the late 1990s witnessed an outflow of skilled young French people, who found jobs much more easily in Britain or the United States than in France (*International Herald Tribune*, 10 March 1998). On the basis of an official report (Sénat 2000), one can estimate that between 1995 and 1998, 300,000 skilled French people (most of them young) have left France for the OECD countries (mostly Britain and the United States)—that is, more than one-tenth of the annual number of registered French students and roughly one-half the number of university diplomas granted in one year.

empirical literature: the many caveats to the superficially compelling arguments in favor of a race to the bottom in social matters (Bean et al. 1998; Andersen, Haldrup, and Sorensen 2000; Brown 2000); and the lack of correlation between the absence of *core* labor norms and trade performance (meaning that countries without core norms do not fare better than countries with such norms) although the same cannot be said in the case of *non*-core labor norms (OECD 2000a).

The second competitive force flows from the right of establishment that allows firms to be established in one EC member-state and operate in another one. Article 43 (ex 52) of the Treaty of Rome explicitly prohibits "restrictions on the freedom of establishment of nationals of a Member state into the territory of another Member-state," and Articles 44 (ex 54) to 48 (ex 58) specify the ways to implement this key prohibition. These provisions could have a huge impact if they are massively used by self-employed, often relatively unskilled people, such as bakers, haircutters, and shopkeepers (i.e., managers of and workers in very small firms, which so far have not been directly involved in EC internal liberalization). Self-employed people can locate the headquarters of their own firms in the EC member-state offering the best public services (health, police, pension, etc.) at the lowest prices (business taxes, social security contributions, etc.) and yet continue to work in their member-state of origin. For instance, a French haircutter could register his or her firm in Britain (where he/she pays business taxes) and work in France (where he or she pays income tax) without regulatory barriers.

Such cases have already raised public attention (*International Herald Tribune*, "Finding the System Too Taxing, French Flee", 16 April 1998, 1). It is difficult to forecast the future magnitude of this phenomenon. If large, it will change dramatically the balance between trade, capital mobility, and labor mobility in the EC. A large portion of relatively unskilled labor will become de facto as mobile as skilled labor and capital—reducing substantially the scope of the argument (Rodrik 1997) about potential pressures exerted by trade on social cohesion. Of course, the member-states with the lowest ratios of social benefits to social costs are doing their best to limit this outflow of firms and revenues by curbing competition among member-states through fiscal harmonization.

## Competition Policy: Market Power and Subsidies

Since the mid-1990s, the Commission has been the strongest advocate of introducing competition policy in the WTO—making no secret that it considers its own competition policy a model for the world trade system. The Seattle Commission text illustrates this stance by ranking competition issues as the third topic in commercial policy matters and devoting more space to them than to services. It describes a wide program: (1) "core" principles and "common" rules on the scope of competition law and on its procedures; (2) "common approaches" on anticompetitive practices with a significant impact on international trade and investment (e.g., hard-core cartels, vertical restrictions, international mergers); (3) international cooperation on notification, consultation, and surveillance; and (4) the use of the dispute settlement system to "ensure that domestic competition law and enforcement structures are in accordance with the provisions agreed multilaterally."

The Parliament and even more the Council have shown less enthusiasm in their texts. This reserve mirrors underlying power struggles within the EC. Member-states are still attached to their own domestic competition policies as recently illustrated by the so-called Schröder Document (see chapter 7). They may feel that the long list released by the Commission for Seattle is a way to use the coming round to expand the Commission's powers in these matters, in particular on issues much debated within the Community (e.g., export cartels or vertical restraints).

EC competition policy has a feature that is essential in the context of WTO negotiations on competition, if there will be such negotiations. The relevant Treaty of Rome articles do not prohibit practices incompatible with competition, only those incompatible with the "common market" (a feature echoed in the Seattle Commission text by the expression "in accordance with the provisions agreed multilaterally") and affecting intra-EC trade. Distortions and restrictions on competition in the EC may thus be permitted, if they fit the common market objective, whereas economically sound practices may be prohibited to the extent that they are perceived as obstacles to intra-EC trade, as has been the case for private selling arrangements (see chapter 4).

The common market objective refers to the other goals mentioned in the Preamble and in Articles 2 and 3 of the Treaty of Rome (see chapter 1): support of small firms, promotion of research and development (R&D), "fair" competition, competitiveness, social and territorial cohesion, subsidiarity, and democracy. Some of these goals have been perceived as important enough to be explicitly restated in the Treaty articles on market power, state-owned enterprises, and state aid (Articles 81:3 [ex 85:3], 86:2 [ex 90:2], and 87:2 [ex 92:1], respectively), when these articles list the exemptions to be taken into account. Other goals have accumulated over time, such as the encouragement of innovation or the promotion of the competitiveness of European firms.

The multiple-goal feature of EC competition policy helps to explain two frequent reactions to EC proposals on these matters in the WTO forum. On the one hand, WTO members with a competition policy that focuses more strictly on competition issues (e.g., the United States) fear that the EC approach will end up loosening the enforcement of their own competition laws. On the other hand, forces hostile to the introduction of a competition law (including among the 52 countries that have adopted such a law in the past decade) are looking at the introduction of the EC approach in the WTO framework as a possible way to dilute the infant enforcement of their own competition law.

It is important to note that the Seattle Commission text does not deal with all the topics that the Treaty of Rome includes under competition policy. It focuses on one of the two "branches" of EC competition policy, that is, market power issues (cartels, vertical and horizontal restrictions, and international mergers). It scatters under various headings the other topics covered by the provisions of the Treaty of Rome on competition policy (state-owned enterprises, antidumping, regulatory reform, and subsidies), an approach that leads to a superficial treatment of these essential issues. In particular, the Commission text leaves almost completely aside subsidy issues ("state aid," in EC parlance), despite the fact that WTO members would benefit from substituting the EC antisubsidy approach for the GATT countervailing notion.[22]

## Competition Policy as Seen by EC Commercial Policy

The Seattle Commission text limits the scope of competition policy in the WTO to three major topics: cartels, vertical and horizontal restrictions, and international mergers.

### Hard-Core and Export Cartels

The EC and member-state approaches to hard-core domestic (i.e., intra-member-state or intra-EC) cartels are relatively similar. They condemn them, although there are still some key differences in the immunity policy (about denouncing cartel-like practices) and in the available range of sanctions (particularly the existence, or lack, of criminal sanctions against individuals) and in the intensity of enforcement among member-states and the Community (OECD 2000b). These crucial differences may explain why, paradoxically at first glance, the level of cooperation between the EC and the US competition authorities has been minimal in this crucial anticartel activity (Waller 2000).

The European position on *extra-EC* export cartels is a much more open question.[23] In accordance with Article 29 (ex 34) of the TEC, the EC Court of Justice bans discriminatory *intra-EC* export restrictions, but it allows

22. The EC itself will benefit from such a substitution, because it is using the GATT countervailing approach for *extra-EC* imports with a worrisome drift (see appendix B).

23. The same can be said for export-subsidy policy, which remains within the competence of the member-states and under the discipline of the OECD Agreement on Export Credits. For the latest available year (1995), the export assistance share in total assistance to industry varies from 0 percent (Spain) to 4 percent (Belgium, Britain) to 13 percent (France) to 20 percent (Germany) to 55 percent (Finland) (OECD 1998d).

schemes restricting exports as long as they make no distinction between products to be sold on domestic markets and those to be sold on export markets (the 1979 *Groenveld* ruling). On the one hand, the Commission argues that it has jurisdiction over such export cartels, and it is favorable to a ban. However, the requirements it imposes for the material evidence required to convict firms are so strict that they explain the lack of deterrent effect of this ban. Moreover, the Commission tends to examine the extent to which export cartels hurt other EC firms (e.g., the implementation of the UN Conference on Trade and Development [UNCTAD] Liner Code on maritime routes between French and African harbors that excluded Danish shipping lines), an approach that can lead to tacit acceptance of cartels. Finally, it ignores the impact of antidumping measures on the formation of such cartels (see appendix B).

On the other hand, member-states consider this issue under their own competence—at least for their own national export cartels that have no effect on EC markets (if that is possible). Their views on export cartels vary from prohibition to tacit acceptance—depending on the relative magnitude of the rents that the domestic cartel extracts from domestic consumers and those that it can extract from foreign consumers. This complicated situation leaves doubts about the EC's capacity to have a common position on this topic in the WTO forum.

## Horizontal and Vertical Restraints

Article 81 (ex 85) of the Treaty of Rome deals with "concerted practices" and Article 82 (ex 86) with "abuse" of dominant position. In the case of *horizontal* restraints (agreements between producers of substitutable goods and services) other than cartels, EC competition policy—with its multiple goals defined by the Treaty of Rome—has generated a high degree of discretion and subjectivity in implementation. These complexities in turn have created time inconsistencies in EC competition policy, and wide differences of views and actions between EC and member-state competition authorities—even about essential points, such as the definition of what constitutes a restriction of competition, or the interpretation of the "technical or economic progress" that certain restrictive practices could bring (Neven, Papandropoulos, and Seabright 1998).

Differences of views and actions in the EC about *vertical* restraints (agreements between producers of complementary goods and services) are even wider, because the Treaty of Rome does not distinguish between vertical and horizontal restraints (it was written at a time when vertical relations were seen as dangerous for competition as horizontal agreements).

As a result, the Commission has been forced to use a series of convoluted "exemptions" under Article 81:3 (ex 85:3) so as to have a more friendly approach to vertical restraints than to horizontal restraints. "Block" exemptions (for exclusive distribution, purchasing, patent licensing, franchising, R&D cooperation, technology transfer, car distribution, and certain types of agreements in the insurance sector) and "individual" exemptions for other vertical restraints (subject to the fulfillment of specific conditions by the firms involved) have allowed the Commission to take into account the positive aspects of vertical relations.[24] Some exemptions cover key practices in large sectors (distribution of beer, cosmetics, and petrol, liner conferences in shipping, joint capacity planning in air transport, etc.), whereas other exemptions have allowed clear restrictions on *intra-EC* competition, as is best illustrated by the car distribution agreement (see appendix A, case 12)—a paradox only if one forgets the basic Treaty logic, according to which competition policy is an instrument of economic integration, as underlined above.

## International Mergers

In the domain of international mergers, the Seattle Commission text evokes the need for "common approaches," and the possibility of incorporating "negative or positive comity" procedures into the WTO framework, in order to solve the informational problems faced by national competition authorities undertaking investigations (but excluding the possibility of binding obligations to investigate on behalf of another country).[25]

The most often mentioned issue in this domain is the extraterritoriality dimension of many merger decisions made by competition authorities—a dimension increasingly unavoidable in a globalizing economy because competition authorities are concerned with consumers' welfare, *not* with the location of producers. On this point, the EC position shows an increasingly extraterritorial reach. Until the late 1980s, the EC was reluctant to assert extraterritorial jurisdiction, but in 1988, the Court of Justice moved toward some extraterritorial reach with the *Wood Pulp* case. However, this ruling focused on the behavior of *all* firms (domestic and foreign) in *European* markets—hence, on enforcing competition disciplines in the domestic market in a nondiscriminatory way, an approach perfectly compatible with GATT Article III on national treatment.

By contrast, in 1997, the Commission approach to extraterritoriality with the *Boeing-McDonnell* case was very debatable. The Commission dealt with

24. The provisions for block exemptions for exclusive distribution, purchasing, and franchising have been clearer since June 2000: Vertical agreements between firms whose combined market share is less than 30 percent are immune to Article 81:1 (ex 85:1), unless these arrangements contain blacklisted restrictions. By contrast, the block exemption on car distribution will be under increased pressure until 2002 to be abolished or reformed.

25. These two procedures have been defined in the 1991 and 1998 United States-EC Agreement regarding the application of competition laws. Under the negative comity clause, each signatory takes into account the other's interests when enforcing its own competition law. Under the positive comity provision, the United States and the EC can request the other jurisdiction to enforce its laws with respect to competitive conduct within its borders that is harming the other jurisdiction (Janow 2000). For a detailed assessment of the comity approach, see Griffin (1994) and Evenett, Lehmann, and Steil (2000).

the possible and *indirect* (hard to document in a robust way) effects of a merger between two US firms (Boeing and McDonnell-Douglas) on an EC producer (Airbus) by dictating conditions for the behavior between the *foreign* seller (Boeing-McDonnell) and *foreign* buyers (US airlines) in a *foreign* (US) aircraft market. Such an approach could clearly open a Pandora's box of conflicts about the strategic use of competition policy in the world trade regime—all the more because Airbus has benefited from massive subsidies, and will benefit from additional state aid.

The last essential point is that in implementing Merger Regulation 4064/89 (the EC core legal text in these matters), the EC Commission has increasingly developed an ex ante approach. The extent to which a merger is authorized or not, and the precise conditions for its authorization (in terms of disinvestment) are based on the knowledge, *before* the merger, of the market situation and of its evolution. This approach raises a major issue. It assumes a level of information on the markets and on their ex post developments that is likely to exceed by far the effective level of information available to the Commission, and to the firms involved.

Such an ex ante approach may lead to inappropriate decisions that "overprotect" firms from competition—particularly in a world economy full of unexpected events. The EC Commission and most member-states have followed this approach because, compared to the US Justice Department, they have had few possibilities of acting at a later stage—for instance, by giving criminal immunity to the first cartel member that would reveal the anticompetitive consequences of a merger (e.g., the existence of a postmerger cartel).

## Cost-Benefit Analysis of a Two-Layer System

The Commission's advocacy for WTO competition rules modeled on the EC approach relies on the perceived success of the two-layer system of Community and member-state competition laws. It is thus useful to sketch three aspects of the relative benefits and costs of such a system in relation to a "decentralized" regime (i.e., national competition laws with no a priori common disciplines).

First, because competition policy relies more and more on a case-by-case ("rule-of-reason") basis, similarity of rules does not imply similarity of rulings, contrary to the basic assumption underlying the Commission text for Seattle. "Decentralized" competition authorities enforcing the same disciplines could arrive at different outcomes, either because they weight the same ingredients differently or (assuming they use similar weights) because the producers directly involved, the other producers, and consumers are not equally spread among the jurisdictions, a condition almost certain to be met (Neven and Röller 2000; Cadot, Grether, and de Melo 2000). As a result, even assuming a possible world competition authority (leaving aside the touchy question of the fate of the US Supreme

Court and EC Court of Justice in such a context), *common rules* at the WTO level are not a sure recipe for *similar rulings* by WTO members, even for similar cases, hence for fewer international conflicts.

Second, it is often argued that most member-states would not have developed their own competition policy without the Treaty of Rome's seminal Articles 81 (ex 85) and 82 (ex 86). Formally speaking, this is not correct. France, Germany, and Britain have had a competition law since the 1950s and Spain since 1963—leaving Italy (1990) as the only exception among the large EC member-states since the value of a competition law for smaller EC member-states is debatable. Of course, one can argue that until the late 1960s, competition policy in EC member-states was often an exercise in futility (except perhaps in Germany), but this comment could well be applied to EC competition policy itself.

Since the 1980s, the adoption and enforcement of fully fledged competition policies by EC member-states have been related to an increasingly better understanding of the role of markets. The eight member-states (Denmark, Finland, France, Germany, Luxembourg, Netherlands, Sweden, and Britain) with long-standing competition laws revised them between 1986 and 1998, and the other member-states adopted domestic competition laws during the same period. But the convergence of all these laws toward more similar rules (particularly in Germany and Britain) may be seen as the result of emerging better *general* standards—which influence EC competition policy itself, as in the case of vertical restraints—more than the desire to align with EC standards, although the will to reduce potential conflicts with EC competition enforcement is not absent.

The third aspect of these relative benefits and costs is that casting competition rules in an ironclad treaty can be costly. This is illustrated by the integration constraint imposed on competition policy, and by the complicated "exemption" regime imposed by the Treaty's deficient treatment of vertical restraints.

The conclusion to be drawn from the EC experience is that the focus of WTO discussions for the foreseeable future should not be the adoption of WTO competition disciplines, but rather the adoption of a competition law by *each* WTO member of significant economic size. This adoption would best be done in combination with a "soft" convergence, based on "comities" available to WTO members that take seriously their *own* competition rules—to avoid as much as much as possible the strategic use of competition policies in the international trade context.

## Other Aspects of Competition Policy: Left Outside Commercial Policy?

The EC rules on competition in the Treaty of Rome include three other topics: public undertakings, antidumping, and regulatory reform. None of these issues is included in the section of the Seattle Commission text devoted to competition, but all are dealt with under other headings in a short and imperfect way—quite ironically since competition law would certainly put such topics high on the reform agenda.

### State-Owned Enterprises

The Commission text evokes the issue of state-owned enterprises only in the section devoted to agriculture. Not only does the communication not make a parallel between the many EC intervention agencies that run the Common Agricultural Policy and state-trading enterprises (see chapter 4), but it also remains silent on the many EC state-owned firms still operating in services, from telecoms to banks to airlines.[26]

This silence reflects the ambiguities of GATS Articles VIII (monopolies and exclusive service suppliers) and IX (business practices), which themselves mirror the rather complex treatment of state-owned firms in the Treaty of Rome, articulated in three Articles of the TEC. First, Article 295 (ex 222) affirms the Treaty neutrality with respect to property ownership. Second, Article 31 (ex 37) specifies that no discrimination regarding the conditions under which goods are procured and marketed shall exist in case of state monopolies of "commercial character," and Article 86:1 (ex 90:1) reinforces this principle by stating that public firms, or firms to which member-states grant special or exclusive rights, *shall* observe Treaty competition rules.

Third, however, Article 86:2 (ex 90:2) exempts state-owned firms from this obligation to follow normal competition disciplines when "entrusted with the operation of services of general interest or having the character of a revenue-producing monopoly." Far from simplifying matters, the "statist" reaction in the EC during the 1990s (see chapter 1) generated a new provision (Article 16 [ex 7d] of the Amsterdam TEC version): "Without prejudice to Articles 73 (ex 77), 86 (ex 90), and 87 (ex 92), and given the place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion, the Community and the Member-states . . . shall take care that such services operate on the basis of principles and conditions which enable them to fulfill their missions."

In practice, the effective dose of competition imposed on EC state-owned firms has varied substantially over time. Starting with the 1982 *British Telecom* ruling (see above), the Court of Justice's market-oriented doctrine of the 1980s reached its peak with the 1990 *Höfner* ruling, in which the Court declared that member-states violate Article 86:1 (ex 90:1) if public firms enjoying special or exclusive rights cannot *avoid* abusive behavior when exercising these rights. But one year later, in the 1991 *Corbeau* case, the Court adopted criteria defining "services of general eco-

26. There are four state-trading enterprises in the EC: Electricité de France, Gaz de France, Entreprise Minière et Chimique, and the Italian import monopoly for tobacco (WTO, *Trade Policy Review: The European Community*, 2000).

nomic interest" that severely slowed down the pace at which markets where state-owned firms are operating could be opened to competition (Mavroidis and Messerlin 1998).[27]

## Antidumping

The Seattle Commission text does not go much further than expressing the EC's willingness to discuss GATT antidumping procedures, in the very short section on "trade defence instruments" (see chapter 4). It does not mention that antidumping is one of the elements to be examined by the WTO Working Group on Trade and Competition, and it does not evoke the anticompetitive impact of many antidumping measures (see appendix B)—in sharp contrast with the Parliament text, which interestingly mentions that "an effective competition policy by the WTO contracting parties could, in the longer term, reduce recourse to the trade protection measures which are still needed as part of an antidumping policy."

During the past two decades, the Court of Justice, the various member-state competition authorities (from Bundeskartelamt to Conseil de la Concurrence), and the Directorate General for Competition of the Commission have been unable, and often unwilling, to address the antidumping issue, as is best illustrated by the following two cases. First, in the 1992 *Extramet* case, the Court of Justice annulled a first antidumping duty for having failed to take into account the anticompetitive practices of the complaining firm. But within a few months, the Commission reopened a new antidumping procedure—imposing minimum prices equivalent to duties more than three times higher than the first measures—that is, sending a clear message of "retaliation" to defending firms daring to have recourse to competition authorities in antidumping cases.

Second, the 1996 *Saint-Gobain-Wäcker* case dealt with a merger between two EC firms that were ready to renounce forever their rights to lodge antidumping actions in exchange for the right to merge their silicon carbide activities. In other words, these firms offered to renounce the use of antidumping (and hence to accept a much freer trade regime for this product, which has been subjected to repeated EC antidumping measures for years) as the ex ante "remedy" to the possible dominant position that their merger would give them in the relevant EC market. The proposal was rejected by the Commission, on the debatable ground that it would be impossible to enforce such an agreement—another illustration of the balance between ex ante and ex post instruments (see the discussion of mergers above).

These two cases reveal the *systemic* danger of introducing competition policy into a WTO framework that allows for antidumping regulations.

27. Moreover, in services, EC and member-state competition authorities have often been unable to efficiently rein in the predatory behavior that former public monopolies tend to follow in markets newly opened to competition, because the slow motion inherent in the investigation of competition cases is an implicit cost for entrants (e.g., see appendix A, case 22).

As shown in appendix B, very few antidumping cases deal with predatory pricing (less than 3 percent) or strategic pricing—suggesting that competition policy and dumping practices (as perceived in trade policy) have little in common. By contrast, many antidumping measures have been shown to generate conditions favorable to procartel practices—suggesting that competition enforcement should ideally look at antidumping *policy* (Messerlin 1990). The fact that the two policies have different purposes and constituencies (and very different financial outcomes for domestic complainants) creates a serious risk of subordinating competition policy to trade considerations—rather than the desirable converse. Indeed, the evolution of the Treaty of Rome offers the best illustration of how serious this risk is. The Treaty's initial Article ex 91, which subordinated intra-EC dumping issues to competition enforcement, disappeared in the Amsterdam TEC version—a clear, and worrisome, sign of which policy (competition or antidumping) is the more powerful.

### Regulatory Reforms

The Seattle Commission text does not deal with the relations between regulatory reforms and competition policy in the competition section, but rather in the service section (see above) with a minimal reference to *procompetitive* disciplines. Service liberalization has often been perceived as requiring specific, transitory provisions that favor the emergence of new competitors *and* protect them from the most powerful incumbents for a given period. Such "asymmetric" regulations often require very intrusive rules—from imposing mandatory cost-based pricing on the incumbent during the transition period to banning competition from incumbents. These intrusive rules can be discriminatory, even firm-specific, and they can be enforced by ad hoc regulatory agencies. As a result, these rules represent a danger in the long run both for competition disciplines, which are horizontal by nature, and for the WTO principle of nondiscrimination between countries, and a fortiori between firms.

## State Aid

The almost complete silence on state aid of the texts released for Seattle by the three European institutions is all the more striking because subsidies are still reported (in the 1999 business survey on obstacles to intra-EC trade) as the third or second most important obstacle to the Single Market by 28 percent of the small and medium-sized enterprises, and by 36 percent of the large firms. (What follows offers an explanation of why state aid seems more important for large than for small and medium-sized enterprises.)[28]

28. See http://europa.eu.int/comm/internal_market/en/update/score/score5.htm, dated 2 December 1999.

EC rules on state aid are relatively close to GATT rules on subsidies except that they are also enforceable in services, whereas GATS Article XV on subsidies in services is still largely an empty shell. Article 87:1 (ex 92:1) of the Treaty of Rome states the general principle that "any aid granted by a Member-State or through state resources, in any form whatsoever which distorts or threatens competition by favoring certain undertakings or the production of certain goods, shall, in so far as it affects trade between Member-states, be incompatible with the common market." The rest of Article 87 (ex 92) lists exemptions to this general principle that are close to those included in the Uruguay Subsidy Agreement: (1) sectoral state aid for "structural adjustment" essentially applied to the EC car, coal, shipbuilding, steel, and synthetic fiber sectors; (2) horizontal subsidy schemes for regions, urban districts, environmental, or R&D activities (with certain schemes of utmost importance for the EC enlargement, hence for EC commercial policy; e.g., 46 percent of EC population in 1997 was located in regions eligible for regional aid; see chapter 6); and (3) the systematic possibility of "compensating" all the EC firms for costs related to "services of general economic interest."

Beyond these similarities, there are two essential differences between EC and GATT rules in these matters. The first concerns the *type* of antisubsidy policy to be pursued. In this respect, the traditional GATT approach is notoriously inadequate, because it is not based on the right motive to curb subsidies. It does not perceive a subsidy as a transfer from domestic taxpayers to foreign consumers, but as a support to domestic producers that would be "unfair" to foreign producers. As a result, the Uruguay Subsidy Agreement imposes the wrong instrument to fight trade-related subsidies, namely, "countervailing" duties that the importing country could impose on subsidized imports, that is, on its *own* consumers—instead of leaving them to enjoy available foreign subsidies.

Two recent WTO panels (on Australian leather and Brazilian aircraft) have tried to limit this traditional GATT flaw by suggesting that countervailing duties should be limited to the level of injury suffered, not up to the level of subsidization. This solution is similar to what already exists in antidumping enforcement, and it is likely to drift in a similar way. Investigations will come up with more inflated levels of injury than in the past.

By contrast, EC antisubsidy policy relies on the right instrument: the ban on (or at least alteration of) state aid by the Commission. The experience accumulated during the past 20 years of increasingly tight Commission enforcement provides three major lessons for the WTO. First, the bulk of the visible state aid granted by member-states to the manufacturing sector between 1984 and 1992 remained concentrated in six industries: textiles, clothing, synthetic fibers, glass, steel, and cars. (Anecdotal evidence does not suggest large changes in this sectoral distribution during the 1990s.) The fact that all these sectors are characterized by a higher level of overall protection than the whole EC manufacturing sector (see table 2.1) reinforces the impression conveyed by chapters 2 and 3 of protection peaks in these sectors.

Second, table 5.4 shows the relative stability of the *overall* nominal amount of subsidies in the EC economies between 1990 and 1997, with a significant substitution of EC subsidies for member-state aid. However, contrary to what happened with the communitarization process in trade barriers (see chapter 2), this substitution was accompanied by noticeable changes in the sectoral distribution of subsidies—away from certain industries, and toward agriculture and certain services.

Third, substitutability between the endless forms of subsidies generates an enforcement problem for the EC antisubsidy policy in the long run. Available evidence suggests that the EC's stricter state aid control after 1987 generated a wider range of types and sources of subsidies, which were more difficult to monitor (Messerlin 1999). Examples of endless creativity with subsidies abound—from subsidies for labor costs apparently granted to all labor-intensive activities, but de facto limited to some sectors (textiles, apparel, footwear) to aid for new purposes (increasingly generous preretirement schemes, aid for foreign investment in joint ventures with Central European firms) to subsidies granted by increasingly low levels of subnational entities to subsidized inputs (land, electricity, movie studios) often produced by public enterprises, and to implicit subsidies generated by state guarantees, as is best illustrated by the banking, electricity, and railway sectors.[29]

This evolution suggests the need to interpret with caution the level and decline of EC subsidy rates between 1990 and 1997 that are reported in table 5.4. In fact, the level of subsidization may be significantly higher, as is suggested by a study (Hallaert 2000), according to which, in the mid-1990s, French total subsidies in manufacturing *and* services would still represent 5.8 percent of French GDP (indeed, a result more in tune with the above-quoted business survey than the official figure of 2.1 percent shown in table 5.4).

29. E.g., Germany grants state guarantees (*Anstaltslast* and *Gewährträgerhaftung*) to certain banks (*Landesbanken* and *Sparkassen*), that are equivalent to subsidies on the cost of refinancing or to subsidies to capital (Austria has similar regulations) (Koenig 2000; Schneider 2000; Winckler 2000). In the case of WestLB, it has been shown that this indirect aid allowed WestLB to cross-subsidize its activities in the London competitive markets with its protected activities in Germany. The German government tried to grandfather these guarantees by a protocol to the Maastricht TEC version but failed to do so. In July 1999, the Commission ordered WestLB to repay €0.8 billion in illegal subsidies. However in November 2000, German regional politicians were still struggling with the various alternative plans to reform the *Landesbanken*. The treatment of investments in railway tracks or other large infrastructure of state-owned firms is not without similarities to this guarantee issue.

The subsidy resilience in the EC raises an interesting question for those manufacturing sectors that are considered liberalized but that continue to receive substantial state aid. As stressed by Snape (1987), subsidies become rapidly very costly when trade barriers are eliminated. The observed resilience may thus reflect either lobbies powerful enough to be able to impose the use of a visibly costly instrument, or more likely the fact that certain extra-EC and intra-EC barriers (e.g., antidumping measures and/or technical regulations) have survived past liberalization efforts and reduce the costs of subsidization.

The second essential difference between the EC and WTO subsidy regimes is that in the EC, state aid control is a Commission "monopoly": Article 88 (ex 93) grants to the Commission *alone* the power to ban or modify subsidies found incompatible with the common market, and the Commission "shall keep under constant review all systems of aid existing" in member-states.

This dramatic power devolution is often mentioned as a key advantage of the EC regime—in comparison with the US regime, for instance, where the Supreme Court is the only institution able to restore some control over local subsidies. However, this argument deserves a caveat for the following three reasons. First, if such power devolution undoubtedly allows simpler, stricter monitoring of small-state aid, it rapidly faces its limits when large subsidies are granted to large or to state-owned firms. In these cases, the Commission does not have the necessary political muscle to confront member-states—distorting its monitoring ability. As a result, and paradoxically, the Commission's antisubsidy policy may be the source of more distortions than no antisubsidy policy, to the extent that it increases the subsidy rate of large and massively subsidized firms *relative* to the rate for the other firms, which are subjected to stricter disciplines—this may explain the noticeable difference (in the above-quoted business survey) between the perception of state aid by small and large firms.

Second, such power devolution does not exempt the Commission from balancing distortions on competition generated by subsidies with the pursuit of other economic and social aims, in accordance with the Treaty provisions. Such balancing requires a *political* consensus in the EC, that is, involves *in fine* member-states. As noted by Besley and Seabright (2000, 13) when criticizing the Commission's policy, "The Commission presumes that state aid distorts competition, yet it approves 98 percent of applications, often for social or distributional reasons."

Third, the power devolution has induced the Commission to pay much more attention to the interests of the competitors of aid beneficiaries (Ehlermann 1995)—balancing its acceptance of state aid by imposing restrictions on the strategies of the subsidized firms for accommodating competitors, again opening the door to the strategic use of competition policy, as is best illustrated by the airline and banking industries. In the airline cases, subsidized firms have been prohibited from acquiring other airlines, expanding aircraft fleets, increasing the number of flights or seats on specific routes, and pricing aggressively on specific routes. In banking, operational constraints on subsidized banks have included quantitative limits on growth rates, a mandatory distribution of revenues between shareholders and other possible beneficiaries (both conditions to be met for a few years), and a mandatory stability of the bank solvency ratio (a condition to be fulfilled for many years).[30]

The problem is not so much that all these restrictions make the restructuring of the subsidized firms more difficult—giving them good excuses to ask for new subsidies, and making it more difficult for the Commission to enforce its "one time, last time" principle. It is that such restrictions impose severe limits on the competitive nature of the markets in which subsidized firms and their competitors are operating (and in related markets)—that the restrictions limit the liberalization process. For instance, limiting airline seat capacities ultimately facilitates collusion between subsidized and nonsubsidized airlines; because the constraints imposed on the subsidized firms are public, the nonsubsidized firms can align their own prices or quantities strategically (including with a collusive purpose) with those permitted for subsidized airlines on constrained routes, and they can use the rents resulting from such restricted competition to cross-subsidize their price strategies for other routes.[31]

Because the nonsubsidized firms can be EC or non-EC companies, the EC's failure to address properly the state aid issue becomes a problem of interest for all WTO members. To conclude this discussion of the EC experience of power devolution in state aid matters, it appears that the Commission has been really successful only when it has been able to convince a wide audience that subsidies are not the appropriate instrument—because they do not really address economic and social problems, and can be easily captured by vested interests. This remark echoes the conclusion for competition policy. The economically sound answer to competition issues (all those briefly surveyed in this section) relies much more on *domestic* enforcement than on multilateral initiatives.

30. These illustrations refer to the *Air France* and *Crédit Lyonnais* cases, the latter case raising the issues of both state aid rules and regulatory (prudential) supervision (the extent to which the *Crédit Lyonnais* difficulties have been generated or amplified by the failure of the French supervisory authorities, Trésor and Banque de France, is still under investigation).

31. Limiting the collusive impact of antisubsidy policies is as hard as limiting the collusive impact of subsidies. For example, competitors of a subsidized bank are indirectly subsidized if the state aid granted allows keeping the prices of competitors' assets stable, as well as those of the subsidized bank.

## Public Procurement: Such a Big Deal?

The Seattle texts released by the European institutions on the topic of public procurement are among the shortest. They are limited to a call for consolidation of the Uruguay Round results. This brevity, which contrasts with the importance of this issue in the Single Market context and for certain EC trading partners during the Uruguay Round, reflects the intrinsic difficulties of liberalizing in this domain, including within the EC, and the almost simultaneity of slow intra- and extra-EC liberalization.

The Treaty of Rome implicitly covers public procurement. Articles 28 (ex 30) on free movement of goods, 43 (ex 52) on freedom of establishment, and 49 (ex 59) on freedom to provide services govern all contracts (however small) awarded by European public bodies. However, the first directives adopted in the late 1970s to implement these general principles were ineffective—hence the need to include public procurement in the SMP. Seven basic SMP directives on public procurement thus were adopted between 1988 and 1993—almost simultaneously with the Uruguay Government Procurement Agreement (GPA), which became part of the EC legal regime in 1996.[32]

The implementation of these Directives has been slow and is still conflictual. Not only have all the directives not been adopted by all member-states, but the adoption process in member-state laws has also witnessed the introduction of inconsistent provisions in more than one-third of the cases—forcing the Commission to launch almost 40 infringement procedures against member-states in the late 1990s. Difficulties are particularly severe with the two directives on utilities, which cover roughly a fourth of EC public procurement markets (see table 5.5).

Detailed evidence about the impact of the EC measures covers the very first years (1987–94) of their implementation. But the available evidence for a more recent year shows very modest changes: in 1998, the value of published tenders represented 2 percent of EC GDP, less than one-seventh of the EC total public procurement market (WTO, *Trade Policy Review: The European Union*, 2000). The overall import penetration rate in procurement markets (the ratio of public-sector purchases of foreign origin to total public-sector purchases) increased from 6 percent in 1987 to 10 percent in

32. As of 1999, three directives had dealt with liberalization in "public sectors" on works contracts with Directive 93/37, on supply contracts with Directive 93/36, and on services contracts with Directive 92/50. Directives 90/531 and 93/38 were devoted to procurement procedures of entities operating in the water, energy, transport, and telecom sectors (the so-called utilities or excluded sectors). Two directives dealt with remedies (89/665 for public sectors and 92/13 for utilities). Directive 90/531 is the only one to have reciprocity conditions (based on local content of inputs included in the foreign bids). In 1993, it triggered a dispute with the United States, leading to limited "sanctions" from both sides (exclusion of US and EC firms from public procurement in certain utilities-based markets) that were still in place in 1997 (WTO, *Trade Policy Review: The European Community*, 1995, 69; 1997, 62).

## Table 5.5 EC public procurement markets and operators

| | Estimated size of the procurement markets | | | Entities covered and capable of letting above-threshold contracts, 1995[a] (number of units) | | | |
|---|---|---|---|---|---|---|---|
| | Government | | Utilities | | | | |
| **Country** | **Total, 1994** (billions of euros) | **Above threshold, 1992** (percent) | **1994** (billions of euros) | **Central** | **Subcentral** | **Utilities** | **Total** |
| Austria | 17.6 | n.a. | 5.6 | 200 | 1,000 | 100 | 1,300 |
| Belgium-Luxembourg | 8.8 | 58.9 | 4.6 | 220 | 1,926 | 72 | 2,218 |
| Britain | 97.3 | 61.2 | 27.0 | 841 | 7,884 | 351 | 9,076 |
| Denmark | 9.8 | 16.3 | 3.8 | 177 | 6,480 | 2,999 | 9,656 |
| Finland | 8.8 | n.a. | 2.2 | 150 | 524 | 550 | 1,224 |
| France | 85.9 | 92.6 | 31.4 | 1,625 | 14,854 | 138 | 16,617 |
| Germany | 179.8 | 68.0 | 48.3 | 733 | 18,580 | 10,850 | 30,163 |
| Greece | 4.9 | 39.8 | 2.2 | 660 | 2,549 | 241 | 3,450 |
| Ireland | 3.0 | 21.0 | 1.2 | 129 | 227 | 173 | 529 |
| Italy | 56.4 | 63.9 | 21.7 | n.a. | n.a. | n.a. | 23,512 |
| Netherlands | 16.6 | 51.9 | 7.8 | n.a. | n.a. | n.a. | 472 |
| Portugal | 6.3 | 39.9 | 2.4 | 433 | 1,349 | 112 | 1,894 |
| Spain | 29.5 | 44.0 | 9.8 | 1,010 | 5,097 | 289 | 6,396 |
| Sweden | 22.7 | n.a. | 5.9 | 900 | 3,075 | 54 | 4,029 |
| EC-15 | 547.4 | 60.5 | 173.5 | 7,078 | 63,545 | 15,929 | 110,536 |

n.a. = not available
EC = European Community.

a. Luxembourg excluded.

*Source: Single Market Review* (1998, vol. 2, 115–23).

1994 (Gordon, River, and Arrowsmith 1998). But this overall rate adds up direct purchases (made by public bodies) and indirect purchases (made by firms working for public contracts). Indeed, the ratio for *direct* imports alone only increased from 1.4 percent in 1987 to 3 percent in 1994.

Because these two last figures add up intra-EC *and* extra-EC purchases, they suggest a very low percentage for *extra*-EC sourcing. In addition, table 5.6 shows wide variations *among* sectors. In particular, the 22 most heavily protected sectors (see chapter 3) exhibit the lowest rates of direct import penetration in procurement markets, another indication of their higher than average protection (notably, paper suppliers operating in one EC member-state have had no success in winning business in other EC member-states; see appendix A, case 6).

Such large differences between direct and indirect purchases suggest that public procurement relies largely on domestically located suppliers, with foreign companies eager to bid in procurement contracts in a member-state establishing a subsidiary in the member-state in question. As a matter of fact, a study shows that, although 99 percent of the successful bidders in four "sensitive" British sectors (textiles, paper, medical products, shipbuilding) were located in Britain, only 64 percent of these bidders were British-owned companies (Hartley and Uttley 1994). Such a heavy reliance on establishment makes sense. There are good economic motives for a government or a public body to rely on domestic suppliers (transaction costs are smaller when dealing with local firms than with firms located outside the country, so preferences in procurement can be welfare-improving; Mattoo 1996; Evenett and Hoekman 1999).

The fact that establishment is costly suggests that small contracts are unlikely to be the target of foreign competition. Table 5.5 gives a crude estimate of this portion of public works, which could be de facto left untouched by liberalization. "Small" contracts represent 40 percent of EC public procurement concerns, with wide differences among EC member-states, leaving only 60 percent of the EC procurement markets as effective potential candidates for extra-EC, and perhaps intra-EC, liberalization. In sum, gains from opening public procurement (hence, forces in favor of liberalization) may be smaller than generally expected—a conclusion that may contribute to explaining the very low ranking of this topic in the text of the three European institutions.

The SMP experience in public procurement suggests a last essential lesson for the coming WTO negotiations. Transparency is of little help if not associated with swift procedures for dispute settlement in cases of allegedly unfair treatment. As is underlined by Gordon, River, and Arrowsmith (1998), the current situation is far from satisfactory in certain EC member-states (Germany, Portugal, Spain, and Britain)—suggesting similar difficulties for implementing the Uruguay GPA in these member-states. Unfortunately, the Seattle Commission text did not include this key conclusion as a lesson that the WTO could draw from the EC experience.

**Table 5.6 Liberalization in select public procurement markets, 1994**

| | | Public procurement purchases | | Winning new business in: | | Public-sector import penetration rate (percent) | |
|---|---|---|---|---|---|---|---|
| ISIC code | Sector or product | Percent of total procurement | Percent of sector output | Domestic markets | Other EC markets | Direct | Indirect |
| 321-2 | Textiles, clothing, footwear | 1 | 2 | | | | |
| | Uniforms | | | 12 | 4 | 3 | 13 |
| 341-2 | Paper and printing | 4 | 9 | 6 | 0 | <1 | 17–19 |
| 381 | Metal products | 3 | 6 | | | | |
| | Office furniture | | | 9 | 2 | 5 | 8 |
| | Boilers | | | 12 | 4 | 4 | 9–10 |
| | Power generation | | | 10 | 4 | 6–7 | 11–14 |
| 382x | Office machinery | 2 | 13 | 17 | 3 | 4 | 22–29 |
| 383 | Electrical goods | 4 | 11 | | | | |
| | Medical equipment | | | 10 | 2 | 5–6 | 19–21 |
| | Telecom equipment | | | 13 | 7 | 6–8 | 18–22 |
| 3843 | Motor vehicles | 2 | 4 | 12 | 3 | 3–4 | 16–19 |
| 384x | Other transport equipment | 2 | 9 | | | | |
| | Railway rolling stock | | | 12 | 10 | 10–11 | 19–21 |
| — | Civil engineering | 34 | 31 | 11 | 4 | 3 | 4–7 |
| — | Business services | 15 | 7 | | | | |
| | Consulting engineering | | | 22 | 4 | 1 | 5–6 |
| — | Other goods and services | 44 | | | | | |
| — | All goods and services | 100 | 11 | 9–13 | 3–4 | 2–4 | 5–9 |

ISIC = International Standard Industrial Classification.

*Source:* Gordon, River, and Arrowsmith (1998, tables 1 and 2).

Rather, it focused almost exclusively on the transparency issue and on regulatory convergence—insisting on the need for a "substantive" multilateral framework of rules, and mentioning only in passing that "effective rules to ensure enforcement will also be vital."

## TRIPS and Investment Issues

This section presents only a brief survey of the issues of TRIPS and investment, for two reasons. First, in contrast to public procurement and competition (which also received limited support in the three Seattle texts reviewed in table 5.1), harmonization of TRIPS and investment has already occurred in other international forums, with a long tradition of plurilateral treaties on TRIPS (dating back, in particular, to the 1883 Paris Convention for the protection of industrial property) and on investment (with the International Monetary Fund [IMF] statutes and OECD codes of liberalization on capital movements, investment, and multinational enterprises). Such international harmonization has gone *beyond* what has been achieved within the EC in a substantial number of instances.

Second, there has been a significant international consensus on de facto liberalization in these domains that does not appear to be under serious threat in the near future. The odd accumulation of roughly 1,500 bilateral treaties on investment has worked reasonably well (at least for large firms), especially because it has been boosted by the progressive elimination of exchange controls and the liberalization of capital markets, amplified by technical progress. Intellectual property rights are becoming more widely acknowledged, despite legitimate concerns about their potential anticompetitive impact if they are unchecked.

All these reasons together suggest that the EC has limited incentives to negotiate on these topics in the coming round. This may explain the existence of noticeable divergence among the three European institutions: TRIPS ranks high on the Parliament list, and investment does the same on the Commission agenda, whereas both issues rank low on the other agendas (see table 5.1).

### Intellectual Property Rights

The Seattle texts released by the European institutions send a clear message of strong opposition to renegotiating the Uruguay TRIPS Agreement, as suggested by some developing countries. Rather, they focus on better implementation of the existing agreements (including by mobilizing more international aid for better enforcement by developing countries) and on better integration of new agreements (such as the 1996 World Intellectual Property Organization treaties on copyrights and on performances and phonograms) into the WTO framework. The only new topics of negotiations envisaged deal with (1) extension of the existing TRIPS protection (in particular eliminating exceptions to indications of geographical origin, a major issue for certain EC farm sectors, such as wines or spirits, and currently an important provider of dispute settlement cases involving the EC) and (2) the touchy, including within the EC, issues of biological diversity (Commission text) and patents on living organisms (Parliament text).

Article 295 (ex 222) clearly keeps TRIPS under member-state competence: "This Treaty shall in no way prejudice the rules in Member-states governing the system of property ownership." As a result, international harmonization of TRIPS often goes beyond what has been achieved within the EC, at levels of both designing and enforcing disciplines (Drexl 2000; Ritter, Braun, and Rawlinson 2000).[33] For key types of TRIPS (patent, copyright), the coexistence of EC and US legal regimes seems an example of successful regulatory competition. Moreover, the WTO dispute settlement has shown its muscle in cases where the EC was a plaintiff (alcoholic beverages against Japan and South Korea, music rights in the United States). For these reasons, one may wonder whether current efforts to create additional European law in these matters make economic sense—except for eliminating constraints imposed by previous EC directives, such as the mandatory translation of EC-wide patents into *all* EC official languages. The fact that additional harmonization at the EC level may be more costly than beneficial is well illustrated by the 1993 Duration Directive, which extended copyright protection from 50 years (the duration imposed by the multilateral Berne Convention and initially enforced by most EC countries) to 70 years (the initial duration in Germany, and the longest duration in the EC until the directive's adoption).[34]

The major issue raised by TRIPS is less a matter of negotiating additional rights and obligations than of getting the right balance between the *multilateral* regime of transitory monopoly rights generated by TRIPS and the *national* competition laws. This delicate balance raises the issue of "international exhaustion," that is, the geographic limits (e.g., through territorial restrictions specified in a license agreement) to be imposed, or not,

33. TRIPS offer rare cases of EC infringement procedures launched against member-states because they have failed to adhere to international conventions (Ireland and Portugal, in the case of copyright and related rights), a situation underlining the importance of international law in the intra-EC context.

34. It is doubtful that such an extension could have any positive impact on creativity. Before the Duration Directive, a German work was protected for 70 years in Germany, whereas an EC work was protected for 50 years in Germany (if the home country of the EC work enforced the Berne duration). The 1992 *Phil Collins* ruling of the Court of Justice stated that a work should be protected for the same duration in a given member-state whatever the duration in the home country might be. This shift from home to host rule means the sacrifice of mutual recognition for harmonization, allegedly in the name of nondiscrimination but more surely for the benefit of vested interests.

on the use (exhaustion) of a given type of TRIPS. In its 1971 *Deutsche Grammophon* ruling, the EC Court of Justice stated that it was against the Treaty provisions (Articles 28 [ex 30] and 30 [ex 36]) for a manufacturer to exercise its copyright conferred upon it by the legislation of a member-state "in such a way to prohibit the sale in that Member-state of products placed on the market by him or with his consent in another Member-state solely because such distribution did not occur within the territory of the first Member-state."

In other words, the Court imposed the exhaustion principle *between* EC member-states; a few years later, this principle was extended to patents and trademarks. In its 1998 *Silhouette* ruling in a trademark case, the Court of Justice made clear that there is no such exhaustion principle with respect to imports from a non-EC country (in other words, an EC right-holder can restrict extra-EC trade by opposing parallel imports) unless there is an international agreement between the EC and the third country. Such a dual approach (exhaustion between member-states, but not between the EC and third countries) increases the capacity of EC right-holders to segment EC and world markets—hence increasing the overall protection granted to EC markets, and harming competition in the EC markets in the absence of effective competition policies (Maskus 1997). These complicated trade-offs between TRIPS and competition enforcement will involve EC and non-EC countries, and their case-by-case examination may end up in the WTO dispute settlement system, keeping a close link between intra- and extra-EC liberalization in TRIPS matters.

## Investment

Unlike the Council and Parliament Seattle texts, the Commission text has a long section on investment, but it does not go much further on substance than the two other texts. It consists of a mere catalogue of good intentions. It reaffirms the EC conviction that the WTO is the appropriate forum for negotiation, that the WTO principles of nondiscrimination and transparency are sufficient for dealing with all the issues at stake, and that the WTO bottom-up approach to commitments (already used in services) would be the correct procedure for further liberalization. But the Commission text does little to clarify and reconcile the conflicting goals listed: protection of investment versus the right to regulate, growth objectives versus sustainable development (the latter being implicitly used as a global escape clause with respect to economic reasoning), long-term investment versus short-term capital movements, and so on.

This fluffy approach may reflect the ghost of the failed OECD negotiations on the Multilateral Agreement on Investment. More deeply, it mirrors the fact that intra-EC and extra-EC liberalization of capital flows have been achieved *simultaneously*, because they have been driven by forces or institutions *wider* than the EC. The initial Articles ex 67 to ex 73 of the Treaty of Rome did not include strong commitments on capital liberalization—to the point that in its 1981 *Casati* case, the Court of Justice found no legal basis for imposing unconditional free movement of capital. Moreover, until the 1980s, barriers imposed by member-states on extra- *and* intra-EC investment flows were mostly indirect (they consisted of exchange controls, payment restrictions, discriminatory regulations on interest and stock exchange transactions, and so on).

These barriers have been eliminated either through *unilateral* initiatives (e.g., the 1979 British elimination of exchange controls, or the 1986 "Big Bang" initiative for the London Stock Exchange, both imitated by other EC member-states during the 1980s and 1990s), or by *multilateral* or *plurilateral* actions under IMF, Bank for International Settlements, or OECD auspices (Henderson 1997). Because the EC as such is not a member of the IMF or OECD, member-states *only* have been in the driver's seat in both cases. The EC as such was not in charge, as is best illustrated by the fact that the last two OECD countries to eliminate exchange controls in 1994 were Greece and Iceland—an EC and an EEA member-state. The most recent illustration of the marginal role of the EC texts and institutions in investment matters was given by the Nice TEC version. Investment is not subjected to the majority rule by the new Article 133 (ex 113) (except for services, but this is because the GATS includes establishment as one of the four modes of delivery).

This evolution—largely led by extra-EC forces and institutions—has had two different effects on EC capital markets. On the one hand, it has led to much sharper provisions on capital in the Maastricht and Amsterdam TEC versions. Article 56 (ex 73b) prohibits all restrictions on the movement of capital and on payments, not only between member-states, but also "between Member-states and third countries."[35] In fact, notifications to the OECD of the remaining barriers show that 11 EC member-states have the same reservations for *both* EC and non-EC countries, leaving only four member-states with more reservations for non-EC than for EC countries (in order of decreasing importance, Belgium, Italy, France, and Portugal) (*Single Market Review* 1997b). More important, worldwide liberalization has generated enough competition in EC financial markets to counterbalance protectionist provisions in the Investment Services Directive or in the other investment-related directives.

On the other hand, the marginal role of the EC as such in investment matters has generated difficulties, and hot disputes with trading partners

35. Treaty articles on capital and payments have been renumbered twice. The initial Articles ex 67 to ex 73 were redrafted as Articles 73b to 73g in the Maastricht TEC version, which in turn became Articles 56 to 60 in the Amsterdam TEC version. For an excellent treatment of the links between freedom of capital movements and macroeconomic policies, see Pelkmans (1997).

about the scope of the reciprocity concept included in Article 49 (ex 59) in the case of financial services. Under the Second Banking Directive, which is part of the SMP, non-EC banks can enjoy the benefits of the Single Market under the same conditions as EC banks—except if it can be established that reciprocity is not guaranteed by the trading partner (EC banks do not receive national treatment in partner financial markets). This type of reciprocity is permitted by the OECD Code of Liberalization of Capital Movements, but only a few member-states have notified related measures. As a result, the EC-wide reciprocity provision under the Second Banking Directive opens the possibility of introducing *new* reciprocity requirements in the other member-states (something not completely legally impossible in the code context, but certainly fundamentally opposed to its goal of liberalizing capital flows). In other words, it opens the possibility of a decision by an institution, the EC, that is not a member of the OECD, to be implemented by member-states that are OECD members.

As a result, most of the remaining limits on capital in the EC flow either from discretionary (often opaque) decisions from EC member-states (see the discussion above on restrictions in services), or from specific EC directives not directly related to investment issues, such as the definition of what constitutes an EC firm, for instance an EC air-carrier (sectoral regulations), the Works Directive (public procurement), the Merger Control Directive (competition), or the Work-Time Directive (labor issues). These limits reflect either concerns unrelated to capital flows (with no effort to generate consistency between the various provisions) or certain difficulties of the EC to adopt a clear policy of market opening, probably because most of the EC economies are *both* large exporters and importers of capital, an ambivalence existing for other OECD countries (Graham and Krugman 1989).

## Concluding Remarks

In Seattle, EC commercial policy included a vast set of topics for negotiation and it adopted very specific ways to address certain issues, particularly in services. The wide range of topics tabled was counterproductive. Because it was in contrast with the EC's reluctant, even hostile, approach to past rounds, such an encompassing approach generated the suspicion among certain trading partners that the EC wanted to bury the coming WTO round under a gigantic Tower of Babel. This suspicion was followed by interrogations when glimpses of the EC's *detailed* proposals often suggested a narrow scope for certain aspects of the negotiations (e.g., a very narrow definition of energy services). Finally, the EC's tendency to "export" the SMP as a model for the WTO—in particular its approach in services, which is heavily loaded with regulatory convergence and sectoral perspective—generated fears among many EC trading partners. As a result, the EC should ideally modify its Seattle stance on commercial policy in two ways.

First, the EC should abandon any effort to include three topics in the coming round: trade and labor issues, competition policy in its market power component, and trade and investment. Such changes should *not* be justified by considerations related to WTO tactics or politics. Rather, they should be seen as deeply consistent both with the philosophy, history, economics, and politics of the Treaty of Rome, and with a sound general economic approach, as shown by Maskus (2000). For instance, it is far more important for the EC to remember the sound economic and political reasons for which it has rejected (and still does, as most recently illustrated by the Nice TEC version) any direct link between trade and labor issues within the Single Market than to recognize that the "pro-labor" provision of the EC Generalized System of Preferences (see chapter 6) has failed (as the Seattle Commission text resentfully did when stating that such a clause "depends on the willingness of developing countries to apply for the incentives offered").

In these three domains, the EC should trust its *own* history, which shows (in a perfect match with economic analysis) that direct, *not* trade-related, instruments and policies are the best ways to reach the goals targeted. If really convinced by the merits of competition policy, the EC should induce every WTO member (including itself) to adopt and enforce such a policy, independent of trade-related considerations—hence protecting it against potential abuse as a strategic instrument in an international environment.[36] The EC should also commit itself to sign a framework agreement on cooperation (based on negative and positive comities) between competition authorities on a *nondiscriminatory* basis—that is, with any WTO member as soon as it fulfills the basic conditions of the agreement. If it is interested in improved labor standards in developing countries, the EC should remember its own history of de-coupling trade and labor issues and of implementing direct aid when necessary, such as intra-EC regional subsidies. In particular, it should focus on aid to education in developing countries (particularly for working children)—a key determinant of labor relations in the long run. Such an action does not require large funds, all the more because there is no reason to grant such aid unconditionally to all developing countries.

The EC should not be afraid of insisting on conditionality in these matters. There is no reason for the EC to give such aid to education in advanced developing countries (such as Brazil) that have reached a level of per capita income comparable to the European level of the early 1900s but

36. Quarrels over a possible capture of competition policy by trade interests have already emerged, as illustrated by the debate between US Congress members and EC Competition Commissioner Mario Monti ("Monti rebuffs US attack on merger policy," *Financial Times*, 19 October 2000, 10).

that do not provide the education services (mandatory school) already available in Europe—that is, these countries do not show their will to make their *own* society more equal. Last but not least, the issue of the efficiency of aid is so pressing that the EC should not hesitate to become sympathetic to private initiatives by EC firms or private institutions that could target well-defined social goals (firms may have incentives to fund schools for children working in their plants or living nearby) in an efficient manner.[37]

The second set of ideal modifications to the current EC commercial policy concerns the issues worth being kept on the WTO agenda. They raise two different types of difficulties.

First, there are "constitutional" issues—aiming to improve the WTO's basic legal framework. In particular, four issues could benefit from the EC experience—although, paradoxically and sadly, they are absent from the current EC proposals: (1) facilitating a progressive focus on only two "modes of delivery" of services (cross-border and establishment) in future schedules of commitments, and shifting away from regulatory convergence and a sectoral perspective toward an approach based on as unconditional mutual recognition as possible and on a horizontal (cross-sectoral) approach; (2) making the WTO agreement on antisubsidy measures closer to the EC approach on state aid, that is, banning or curbing aid granted by the subsidizing countries (instead of countervailing them by duties imposed by the importing countries allowed by the WTO), or alternatively, introducing the possibility of compensating for the impact of subsidies by improved market access to other industries in the subsidizing countries; (3) taking into account the fact that gains from liberalization in public procurement rely more on a swift and effective dispute settlement mechanism, at the disposal of the bidding firms feeling unfairly treated, than on general rules on transparency per se; and (4) ensuring that the TRIPS agreement will receive the appropriate counterbalance from competition policy enforcement by WTO members.

All these issues are particularly difficult because they require new interpretations of existing WTO texts—the most arduous thing to get in such a consensus-based institution—and because they make sense only if one adheres to a competition-oriented approach—not really the most popular view in the WTO forum. But precisely because of these difficulties, such issues require the patient, long-lasting support of major WTO

37. This "private" option raises the many and complex issues of "labeling" social aid—which are conceptually similar to those evoked in chapter 4 about technical regulations, but much more delicate to address because of their emotional content. The Parliament resolution released for Seattle suggests a code of conduct for EC multinationals operating in developing countries; this is unlikely to be a good tool, because it can be much too easily captured by vested interests (in developing and industrial countries) that have little to do with the social goals targeted.

members, such as the EC, to achieve some noticeable results in the long run—starting with the coming round.

Second, there is the central issue of market access in services—with the perspective of huge gains for the EC, because the EC SMP in services needs a serious external boost to overcome all its limits and become more complete and less reversible. This topic raises a fundamental problem of governance: getting all the expected gains from liberalization requires sound domestic regulatory reforms. In the EC Single Market Program, which is dominated by regulatory convergence, such reforms so far have largely been the outcome of a purely political process. Member-states have been "trading" regulations that could favor or protect their domestic firms—often at the cost of slowing down the whole process of increased competition, and making liberalization much less profitable than initially expected. Most EC member-states still fail to recognize that such a purely political process cannot ensure the best possible regulatory reform, particularly the best possible balance between the elements to be harmonized and those to be subject to mutual recognition.

A ray of hope could come from the new strategy in services launched by the Commission in March 2001 (European Commission 2000b). This strategy relies on the basic fact that services are much more tradable than is generally believed (Messerlin 1993) and it consists of three key components: (1) a horizontal approach, to be supplemented with the sectoral approach; (2) an effort to facilitate cross-border trade in services and to eliminate the unnecessary legal requirements of establishment imposed by member-states; and (3) a review of the existing directives in services (like those in technical regulations) in order to increase the role of mutual recognition by introducing nonlegislative solutions (such as codes of conduct, leaving harmonization at a strictly necessary minimum). If properly enforced (a first indication of that will be how the analyses to be carried over in 2001 will be done), this new strategy would have a dramatic impact on the EC service policy in the WTO. It would make the EC much more in tune with its major trading partners. For instance, the EC would be much more at ease in adopting the new tools of negotiations currently envisaged in the WTO forum, such as "clusters" of services (mixes of sectoral *and* horizontal interrelated services), in addition to the traditional sectoral discussions.

Because it is largely political, the existing SMP process has been and still is almost certain to deliver excessive harmonization. The US experience suggests that "the greatest threat to consumers' welfare is not states and their competition but a uniform national regimen that stifles the power to exit—that is, a monopoly of making" (Easterbrook 1983, 15). The results of the negotiations in the past on core harmonization in services (as in technical regulations) between EC member-states should be analyzed by economically sound cost-benefit analyses. Within the Community, such a task could be initiated by the Commission, but the experience of the *Single Market Review* (38 studies commissioned by the Commission, mostly done by major international consulting firms) has been highly disappointing in terms of quality and independence of mind. Member-states could also contribute to such analyses, but the past has not witnessed a strong interest from them in doing so—although recent initiatives, such as the auditing of the French Cour des Comptes by its Dutch counterpart, may offer interesting perspectives. Last but not least, as indeed is the case in the United States, most of this task should probably be done by independent "think tanks." The problem is that the EC is a place hostile to such institutions, with its combined heritage of inflated member-state bureaucracies of deteriorating quality and a Europe-wide political correctness prone to assume that any criticism of European integration implies hostility to European integration.

Of course, this fundamental problem of governance does not stop at the EC level. It also exists at the WTO level, where the risk of abandoning service liberalization to a pure negotiating process may be even greater than in the EC. Because its own liberalization of services has made the EC more aware of the need for sound cost-benefit investigations and economic analysis, the EC should not be afraid to be a staunch advocate of similar analyses at the world level—preparing WTO negotiations on market access, and assessing their results and implementation in an uncomplacent way.