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NEWGOV

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**Interpreting the Treaty –
The role of the ECJ and the Commission in the areas of mutual recognition
of goods and services and state aid control**
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Summary

In this deliverable, we analyse the role of the ECJ and the European Commission in the areas of mutual recognition of goods and services and the control of state aid. We start by explaining the focus of our project and then turn to the relevance of new modes of governance. Thirdly, we expand on the development of the legal reasoning in the areas of our study. We close with a few observations and puzzles for our future work.

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1. The focus of the project

Because of the way the ECJ and the European Commission interpret the Treaty, European law has deep implications for the policy-making of Member states. These are not only called upon to implement European secondary law (directives), but moreover have to conform to the obligations of primary law, such as the basic freedoms and European competition law. Thereby, domestic policy-making can be deeply implicated, which is the core interest of this project, focusing on the new Member states and comparing their experience with cases of the old Member states where appropriate.

In order to complement traditional Europeanisation research with its strong focus on the implementation of European secondary law, we decided to study two areas where European Treaty law and its interpretation have increasingly impacted on Member states' domestic policies: the field of state aid control and the principle of mutual recognition in the internal market for goods and services. Both areas share several characteristics distinguishing them from traditional implementation research: While European secondary legislation can only be adopted with the consent of the European Council, integration in our two areas has largely been driven by supranational institutions, the ECJ and the European Commission. Because of the dominant role of supranational institutions, integration in these two areas is characterized by a high degree of transfer of sovereignty – horizontal transfer of sovereignty in the case of mutual recognition, vertical transfer of sovereignty in the area of state aid control. As a result, questions of legitimacy are highly relevant in these areas. In taking decisions on individual cases, the ECJ and the Commission always have to take into account the legitimacy of its interference into domestic policies on the one hand, and the impact of these decisions on the overall integrity of European Treaty law on the other hand. Thus, in our study of these two areas, questions of Europeanisation and integration are intimately linked.

There are at least two reasons why a focus on the new Member states is particularly interesting. On the one hand, because of the recent accession not that much is known about the new Member states. On the other hand, and crucially, the new member states can be seen to be in a special situation. For one, they have to transpose a large *acquis*, which they did not help to define so that it is unlikely to fit their special situation well. Moreover, there is what Józson (2005: 554) calls a “paradox of legislative harmonisation”. Harmonisation in the new Member states can be seen as more intensive as rules were often transposed “as substitutes for domestic rules, and these rules are applied also for purely internal matters” (Józson 2005: 554). Different to the old Member states, for instance, new Member states do not have separate domestic competition laws but treat domestic and transborder competition matters alike. The domestic political systems of new Member states are therefore much more Europeanised than those of the old Member states which often continue their domestic legal regimes alongside European laws. At the same time, however, Europeanisation is more superficial in the new than in the old Member states, as the state and societal capacity in these countries is weaker and support for the implementation and enforcement of rules may be lacking.

Originally, the aim had been to look at the *acquis communautaire*, and to analyze what happens when it comes to conflicts between domestic policy-making and the *acquis*. In this context, this first deliverable was meant as an overview of the interpretation of the ECJ of the four freedoms and competition law. New modes of governance were relevant in this conception in several ways: they could play a part in easing conflicts between the *acquis* and the new Member states; an analysis of the impact of old modes of governance was useful as a foil against which to judge the impact of new modes of governance; and new modes of governance could conflict with the *acquis*. One example where rulings of the Court can directly or indirectly constrain forms of new European governance, is the subjection of agreements of

social partners to European cartel law (Vousden 2000: 190f). In Albany (C-67/96, 21.9.99) the ECJ denied the relevance of competition law for agreements of the social partners because the matter at issue was a question of pay. This raised the question, whether agreements of the social partners concerning general socio-economic matters, for instance strategies for the reduction of unemployment, would be similarly exempted. Or if the Court would prohibit them despite the fact that such agreements going beyond the negotiation of pay are part of the “European Employment Strategy” (Vousden 2000: 189f).

While we still believe in the merits of our original conception of the project, we had to modify it to a certain extent in view of the fact that conflicts between the new Member states and the *acquis* are slow to develop. As outlined above, we therefore decided to narrow our focus to an analysis of the impact of the European state aid regime and the freedom of goods and services with the concomitant duty of mutual recognition.

Mutual recognition is the principle on which the single market is built. Stemming from an innovative interpretation of the freedom to trade goods in the Cassis judgment, it allowed the Community to push the realisation of the single market despite the impossibility to agree on the harmonisation of rules. With mutual recognition it is assumed that Member states’ regulations present alternative solutions to the same underlying problem. By being lawfully marketed in one Member state, products may also enter the markets of other Member states. Regulation falls exclusively under the responsibility of the home state. Home-state control, however, implies a horizontal transfer of sovereignty (Nicolaidis 1993: 491). Member states can no longer guarantee a certain level of regulation of products marketed to their nationals. Governments have to trust other Member states to regulate and control their companies sufficiently, making mutual recognition quite a demanding principle of market integration (cf. Nicolaidis 1993: 488-491, 495; Maduro 1998: 101-149; Armstrong 2002: 229).

Under the assumption that, in spite of sustained cooperation, states do not have a full capacity to monitor their counterparts’ regulations, they may not in effect even know at a particular moment what rules are being applied on their own territories (Nicolaidis 1993: 497).

The legal foundations of European state aid control are laid down in Articles 87-89 of the EC Treaty and have remained almost unchanged¹ since their incorporation into the original Treaty of Rome. In short, Article 87 generally prohibits national state aid and lists certain exemptions from this prohibition. Article 88 contains the basic procedural rules of the European state aid control system, empowering the European Commission to take the leading role in European state aid control. According to Article 89, the Commission may propose secondary legislation on the application of Articles 87 and 88.

In law European state aid control has been seen as “the ‘poor relative’ of European competition law” (Hansen/Van Ysendyck/Zuhlke 2004: 202) for a long time: “Much of state aid law enforcement was (and still is) viewed as politically motivated, with unclear standards being applied to situations where national government policies are at stake” (ibid.). Despite this undoubtedly political character, EC state aid control policy has attracted little attention in political science, much less than competition policy in general. This is despite the fact that EC state aid control has potentially far-reaching consequences for national policy-making: “Controlling Member State aid to industry represents an intersection between implementation of the single market and traditionally national Member State concerns with industrial policy and employment. The evidence suggests that Member States over time increasingly have had to

¹ For an overview of all marginal changes, see Footnote 3 in (Wishlade 2003: 3)

adapt their industrial policies in significant ways to take account of DG IV's state aid policies" (Smith 1998: 57).

Yet, the mechanism of domestic adaptation differs from what is traditionally analyzed in the Europeanization and Implementation literature. Member states do not have to implement European secondary legislation in the field of state aid policy, but EC Treaty law on state aid control comes primarily into play in the process of national policy-making. Hence, EC state aid law is 'implemented' in political practice, i.e. in individual cases of conflict between domestic policy measures and EC primary law. In these cases of conflict, EC Treaty law leaves the European Commission and the ECJ with considerable leeway for interpretation and, accordingly, Member states have to face substantial problems of legal uncertainty in their domestic policy-making. Given this ambiguous character of EC state aid law, it is not always possible to tell in advance, whether a certain policy measure is 'in compliance' or not. Negotiations and individual judgments may be necessary in order to define the precise meaning of certain state aid provisions in an individual case. "Informal settlements [being] very much the norm" (Cini 2001: 197), an in-depth analysis of particular state aid decisions might reveal more political implications than is shown in official statistics on the high degree of positive Commission decisions (European Commission 2005b: 36) or on member states' compliance (Wolf 2005: 87).

2. The role of new modes of governance

With our focus, we research two areas where new modes of governance play a large role. In the area of the freedom of goods and services, mutual recognition can be conceptualised as a new mode of governance. Building on the Cassis-judgment of the ECJ, the European Commission propagated mutual recognition as an alternative to harmonisation, which depends on the classic community method and had been the only way to integrate the common market previously. Mutual recognition allows the integration of previously distinct markets but is not restricted to the economic realm. Mutual recognition in Justice and Home Affairs, for instance with the European arrest warrant, shows the potential that all areas marked by different regulations can be integrated via mutual recognition. Presenting itself as an alternative to the classic community method of devising common harmonised rules, mutual recognition should be counted among the new modes of governance.

There is little agreement as to what new modes of governance (NMG) are. New modes of governance, to start, are those that allow for the provision of governance functions in an innovative, but not yet established, way. Authors who attempt to positively characterise NMG typically emphasise that these new modes achieve governance functions in a less binding way (voluntariness), drawing in a wide range of relevant actors (inclusion). In this way, the legitimacy and effectiveness of political decisions is thought to be enhanced (Héritier 2003: 106). Topics much studied in the context of the debate on NMG are the Open Method of Coordination (OMC), comitology, and independent regulatory authorities. Apparently, there is difficulty in differentiating new modes of governance from governance as such. Moreover, while OMC has been new for the EU and has proliferated into several policy fields, the way Member states coordinate their policies in a non-binding way via OMC is most similar to the coordination achieved in other international regimes such as the OECD or the IMF (Schäfer 2005). And, of course, independent regulatory authorities have been new in the context of the EU but are very established in the US. "New" seems to relate as much to the context of where

a particular mode of governance is brought to bear as to the mode itself and its true novelty.² Rather than attempting a positive definition of NMG which aims at delineating its features, several authors therefore prefer a negative definition, defining NMG in the EU as deviating from the classic community method (i.e. the adoption of directives and regulations by the Council and the Parliament based on proposals from the Commission) (Eberlein/Kerwer 2004: 122; Scott 1994: 1,5). This definition makes it possible to take into account all ‘new’ forms, without limiting the analysis because of previous alternate definitions (e.g. no binding legal measure or the inclusion of private actors as a precondition) (Eberlein/Kerwer 2004: 136).

We do not need to decide here whether it is sensible to speak of new modes of governance or simply of governance modes. Mutual recognition, it is apparent, could be seen to be just as new as the other examples mentioned, such as the OMC, comitology, and independent regulatory authorities. While the principle of mutual recognition originally surfaced in the early 1980s with moves to complete the single market, in the late 1990s it was also transferred to the field of Justice and Home Affairs. Outside of the EU, mutual recognition has also gained in importance, especially within the WTO but also in other trading blocks. We can moreover consider the other characteristics of NMG, and ask how mutual recognition relates to them. If we look at the inclusion of a broad range of actors, mutual recognition typically works when actors (such as companies, and professionals) offer their goods and services abroad. Here, they are specifically actively taking up their rights under mutual recognition, under the assumption that the regulations they abide by are deemed to be equivalent. Thus, as far as mutual recognition works as a mode of governance, it is due to the extent to which multiple actors act according to the principle. If mutual recognition is not used, it cannot function as a mode of governance. In addition, it seems that private actors also play a role in the control of the equivalence of regulations. Thus, established companies in a market seem to monitor the entrance of differently regulated competitors well, and are willing to claim non-equivalence if reasonable.³

If we turn to voluntariness, the case law of the ECJ requires Member states to accept equivalent products of other Member states. However, the extent to which equivalence exists is certainly not clearly defined or easily established. In their assessment of equivalence, actors have much leeway, with the ECJ being the final arbiter. This point will be expanded in the latter part of this deliverable. For the Member states, it is not acceptable to simply let any goods or services which are marketed anywhere into their markets. There is a restriction on equivalent products which allows Member states exceptions from free trade. The need for these exceptions quickly becomes clear when we think of products that, when traded, have particular political implications. Thus, without exemption, the Netherlands could export their liberal drug policy, as it would be possible to sell everything sold on Dutch markets in the whole Community. Of course, this is an extreme example. As Member states remain politically responsible for the products traded in their territory, there are many other instances where clarity is lacking, regarding whether or not the products meet the equivalence condition with possible consequences for health, the environment or other important societal goals. Because of the inherently uncertain nature of where equivalence starts and where it stops, Weiler, for instance, deems mutual recognition inappropriate for building the single market (Weiler 1999: 367/8).

² Considering this, it might be better to omit the adjective in order to prevent that NMG are believed to be inherently new, which might stand in the way of useful comparisons between different contexts of where a certain mode of governance is being deployed – however long it has been used.

³ I thank Wendy van den Nouland for this information.

Although there is an apparent need for exceptions, in fact, it is also clear that there is a fine line between legitimate exceptions and protectionism. Despite the obligation for mutual recognition stemming from the interpretation of the basic freedoms by the ECJ, mutual recognition therefore has more voluntary aspects than other forms of hard law.

Related to inclusion and voluntariness, mutual recognition also embodies many of the claimed benefits of NMG, compared to “old” modes of governance, such as the Community method. Mutual recognition allows for more flexibility, for decentralisation, and increased public-private cooperation, all of which are features claimed for NMG that are thought to improve policy output and compliance, in addition to increasing legitimacy (cf. Kohler-Koch 2005: 14). Thus, mutual recognition may be said “to realize common concerns while accommodating diversity and respecting the institutional integrity and political autonomy of its Member States in all matters where uniformity and centralization are not necessary or not possible” (Scharpf 2001: 13), just as other NMG.

The field of state aid seems astonishing from a NMG perspective. Soft law – guidelines, frameworks, communications, notices, codes of conduct, etc. – is a traditional element of EC state aid control, while codification of formerly soft practices has been undertaken only since the mid-1990s. At first sight there has therefore been a movement away from NMG in this field.

Two interesting questions arise: Under which circumstances does the Commission prefer to control state aid policies by soft or hard forms of law? Does the soft or hard law character of certain instruments matter in practice? According to Cini, the Commission’s initiative to partly codify its own practices should not be seen as a fundamental change of strategy, but rather as a new balancing of “discretion and formal freedom of manoeuvre” against “policy credibility and legal certainty” (Cini 2001: 205). Nevertheless, the decisive factors in determining the appropriate mix of soft and hard law remain to be analyzed. Moreover, it is not clear, whether the theoretical differences between soft and hard modes of governance actually matter in the practice of EU state aid control. Some authors argue that the binding character of state aid law does not depend on the legal form of the instrument (Wishlade 2003: 253). In fact, most of EC state aid soft law is interpreted as ‘appropriate measures’ in the meaning of Article 88(1) of the EC Treaty and it is therefore closely linked to and placed under the strong ‘shadow of hierarchy’ of EC Treaty law. This seems to hold all the more for the enlargement process, where state aid soft law has been declared part of the *acquis* and therefore had the same binding character for the new Member states as European secondary legislation. One might go further and ask whether soft law entailing a high degree of legal uncertainty does not influence domestic policies even stronger than the less ambiguous rules that have already been codified in Council Regulations.

More recent reforms of EC state aid control have introduced or proposed several additional elements of NMG. First of all, the transparency of Commission decisions and of Member states’ overall state aid expenditures has clearly risen. The State Aid Scoreboard, published bi-annually since 2001, allows for a certain comparability of Member states’ state aid expenditure and for an evaluation whether the Lisbon goals are met in the field of state aid policy.⁴ In the current State Aid Action Plan, the Commission proposes to establish a network of national state aid authorities “in order to facilitate the flow of information and exchange of best practices” (European Commission 2005a: 13). The first responses of Member states’ officials

⁴ See URL: http://europa.eu.int/comm/competition/state_aid/scoreboard/analytical_section.html (14.10.2005).

have been rather reluctant⁵. A network of state aid authorities, it has been argued, would simply construct an additional bureaucratic layer. Moreover, it is unclear what could be discussed and what kind of best practices could be exchanged on this level. All actors involved confirm the basically bilateral character of EC state aid control and the existence of mistrust among different Member states. Additionally, individual state aid cases often involve highly confidential information, for example data on the economic constitution of firms that would be very interesting to potential competitors.

3. Interpreting the Treaty: the role of the ECJ and the Commission

The ECJ has undisputedly been a major motor of integration as is recognised by lawyers and political scientists alike. Over time, the interpretation of Member states' Treaty obligations has changed significantly. When interpreting the Treaty, the ECJ generally uses the teleological method and is oriented on the goal of further integration (Pescatore 1983). Thereby, the reach of the Treaty has been consistently expanded, up to a point where for the Member states it has become increasingly difficult to use their remaining national competences given the extent of competences that have been transferred to the Union (Everling 2003: 878).

In competition policy and state aid control, the Commission has traditionally taken the leading role in interpreting and expanding the scope of European Treaty law. In addition to its usual procedural and agenda-setting powers, the Commission disposes of considerable decision-making powers in this area. Based on Article 88(1) of the EC Treaty, the Commission keeps 'under constant review all systems of aid existing' and may propose 'appropriate measures required by the progressive development or by the functioning of the common market'. Using these powers, the Commission has developed an increasingly complex system of soft law and since 1998 also secondary legislation, codifying its own state aid control practices and the case law of more than 250 rulings of the ECJ related to state aid matters.

Before we analyse how the interpretation of the freedom of goods and services and the control of state aid has changed over the years, it is important to guard against too much criticism of the Court. As Keeling points out with view to the criticism of the ECJ's interpretation of the freedom of goods (ex Art. 30, now Art. 28), the Court has to decide when being called upon, regardless of whether the Treaty or secondary law gives it clear indications:

The bulk of the task was, however, left to the Court. It was the Court that had to determine the scope of the prohibition decreed by Article 30. It was the Court that had to decide in what circumstances a measure caught by Article 30 was justified on the grounds set out in Article 36. (...) The expression "creative jurisprudence", which is often used in mock disparagement of courts that give non-obvious answers to questions for which there is no obvious answer, is especially absurd in this context; for whatever the Court did with such scant material, its jurisprudence was bound to be creative (Keeling 1998: 512).

3.1 Interpreting the freedom of goods and services

Over the years, the ECJ has consistently expanded its interpretation of the basic freedoms from a prohibition of discrimination to one of a prohibition of restrictions (Eilmannsberger 1999a; Eilmannsberger 1999b). Interpreting the four freedoms as a *prohibition of discrimina-*

⁵ Information obtained from interviews with various state aid experts, July and October 2005.

tion originally implied that Member states only had to offer *national treatment* to EU-foreigners. Each Member state therefore remained relatively free to determine the quality of goods and services traded in its territory. EU-foreigners had to abide by these regulations of the host country. The latter, however, was not allowed to discriminate against them, for instance by imposing a nationality requirement or by demanding an establishment. If trade was not to be hampered by these different national requirements, it was necessary to harmonise regulations at the European level.

This is different if the basic freedoms are interpreted as a *prohibition of restrictions*. In this case, the regulations of the host country have to be checked and evaluated for their content. As is well-known, the ECJ changed its interpretation of the freedom of goods in the rulings *Dassonville* (1974) and *Cassis de Dijon* (1979) (Alter/Meunier-Aitsahalia 1994). By now, this interpretation extends to all of the four freedoms. The crucial question is whether national rules are a proportionate restriction on the fundamental freedoms for EU-foreigners. Consequently, the Member state is no longer able to regulate EU-foreigners according to its own discretion.⁶ By interpreting the freedoms as a prohibition of restrictions, the regulations of Member states are subject to an external control as to their proportionality (Schneider 1996: 515).

The Court's criteria for deciding whether to enforce mutual recognition constitute a remarkable deviation from international arbitration on trade matters since they lead to questioning the *internal* effectiveness of regulations independently from their *external* effect. In order to make the case for mutual recognition in *Cassis de Dijon*, the ECJ convincingly showed that the incriminated law was not necessary in order to safeguard the public interest since it did not achieve its stated objectives at the domestic level (causality), and could be replaced by alternative requirements on labelling (proportionality). If such a reasoning was accepted it became harder to argue why such laws and regulations should apply at all, *vis a vis* national and foreign producers alike (Nicolaidis 1993: 285f, emphasis in the original).

Domestic policies that constrain the reach of the four freedoms may pass the ECJ, if Member states have good grounds for these restrictions. For judging restrictions, the ECJ applies a *proportionality test*. This has three criteria: Is a domestic measure *suitable* for the proposed policy goal? Is it *necessary* for achieving the objective, or are there less restrictive alternatives? The third criterion asks whether the measure is *proportionate* for achieving the objective. For this, the Court in fact engages in a cost-benefit assessment of the measure, comparing it with the trade diversion effect. Larger economic effects are however not considered – and purely economic aims are no justification for barring the free movement (Józson 2005: 557f). Several barriers have been accepted by the Court as legitimate restrictions, for instance the pluralism of the press, consumer protection, protection of the environment, safeguarding of the financial balance of social security systems, public health, the reputation of the national

⁶ The four freedoms aim at facilitating trade. Therefore, it is not possible for nationals to claim a violation of an internal market freedom with respect to their own government if there is no trans-border aspect. With regard to its own nationals, government is free to act; however, it may be that there are national constitutional principles prohibiting constraints on individuals, if these cannot be shown to be proportionate. – And the proportionality of measures may be difficult to establish if the treatment of EU-foreigners shows that such constraints are not necessary. Thus, the Italian Supreme Court struck down the national prohibition to produce pasta containing eggs as an undue discrimination, given that such noodles from the EU could enter the country (Conant 2002. 14).

financial system, and the preservation of national historical and artistic heritage (Józson 2005: 558).

It is obvious in view of the proportionality test that it is not always clear where precisely the fundamental freedoms constrain the Member states, and where the boundaries of these freedoms are (Randelzhofer/Forsthoff 2001b, Rz 54; Hatzopoulos 2000: 43f). In regulating their economies, Member states have to act under the legal uncertainty that their domestic policies can be challenged at the European level.

The extent of legal uncertainty arising became particularly obvious with the ECJ's change in interpreting the freedom of goods in the ruling *Keck* (C-267 and C-268/91, 24.11.1993) (Reich 1994). In it, the ECJ limited the negative consequences for the Member states of an interpretation of the freedom of goods as a prohibition of restrictions.

Keck can only be understood against the background of the considerable confusion which had been created over the previous few years as a result of the Court treating all types of import restriction as falling under Article 28, whether or not they discriminated in any way against imports. The risk of abuse became increasingly obvious and the Court was driven to ever more far-fetched solutions. By its ruling in *Keck*, which partially reversed the pre-existing case law, the Court sought to set proper bounds to the scope of Article 28 (Oliver 1999: 793, emphasis in the original).

The Court drew a distinction between rules relating to the production and distribution of goods and those relating to certain selling arrangements (like shop opening hours, pricing, or ruinous competition). As long as the latter concern all economic actors in a state and related to national and EU-foreign goods alike, they are not measures equalling quantitative restrictions, and do not fall within the realm of the freedom of goods. Thus, it is only for the production and the distribution of goods that the prohibition of a restriction exists. As regards selling arrangements, the freedom of goods is interpreted merely as the prohibition of discrimination against EU-foreigners, and Member states retain more autonomy to regulate the organisation of their markets (Troberg 1997: 1471, Rz 33). Before *Keck*, the Court had been called upon for all sorts of possible and impossible questions as national actors sought its help in national political conflicts, for instance about the possibility of Sunday trading. This had led not only to an increasing workload, but “the legitimacy of the Court was being eroded by its degree of involvement in judging the reasonableness of any market regulation, something that always involves a sizeable margin of discretionary powers and complex economic and social policy analyses” (Maduro 2002: 52).

Different to the freedom of goods, the ECJ has interpreted the *freedom of services* until now in a much more restrictive way.⁷ The services freedom does not cover the tertiary sector as such, but only situations where services are delivered across borders. In addition, the remuneration and the temporary nature of service delivery are important distinctions (Roth 1988: 41). It is therefore necessary to distinguish the freedom of services from the freedom of movement and of establishment. If someone occasionally works in another country, she will probably profit from the freedom of services. If an EU-foreigner is part of the national labour market, it will be the freedom of movement. If a cabinet-maker offers particularly tailored products across borders, she profits from the freedom of services; if he does it on a continuous basis, it is the freedom of establishment that matters. Important is the difference in regulation: With the freedom of establishment as well as of movement, companies and people are regu-

⁷ Roth (2002) therefore argues that a similar turn as with *Keck* for goods is not necessary for services.

lated in the country where services are being provided. But if the services freedom is being evoked, regulations of the country of establishment (and not so much of service provision) are applicable.

In order to understand this different treatment of services, it is helpful to consider the differences of services trade, compared to the trade of goods. Different to services, goods can travel borders, while for services the delivery most often coincides with consumption, making it questionable how mutual recognition applies. Different forms of services trade can be distinguished:

- With the *active* freedom of services, the provider of services renders himself in the other Member state.
- With the *passive* freedom of services, the consumer of services renders herself in another Member state.
- *Correspondence services* are those that can be delivered across borders without requiring either recipient or provider to move. Examples are financial services, telecommunications and broadcasting (Hailbronner/Nachbaur 1992: 108).

Services are in a certain sense invisible⁸, which is why it is often difficult to separate their production from their consumption. Nevertheless, it is useful to draw this distinction artificially and to differentiate the service product from its delivery (Roth 1988: 44). It allows us to consider in how far the regulation of services differs from that of goods. While we differentiate between product- and process-standards for goods, the regulation of services can concern market access (e.g. certain training requirements), operation (e.g. certain solvency requirements, speed limits), products, and their distribution (cf. Roth 2002: 16).

Keeping in mind the specifics of services trade and regulation, we can look further into the restrictions of the services freedom. The use of the freedom of services is strictly circumscribed: *Continuous, regular activities are not covered*. As it aims at temporary activities, the case law of the ECJ mandates that not all regulations applying to nationals may become relevant. Otherwise, the burden for service providers from other Member states would be prohibitive. For establishments Member states are much freer to apply their own regulations than for cross-border services deliveries. As correspondence services could be offered on a continuous basis from abroad, the question is whether an establishment is needed. This seems to be a prohibitive requirement. However, in such cases of continuous delivery, companies are generally seen to have to observe the rules of their host country. As services delivery is permanent and targeted at the host country, the argument is that it would not be disproportionate to conform to its rules (Randelzhofer/Forsthoff 2001a, No 35; Hatzopoulos 2000: 63f; Roth 2002: 20).

However, Member states can apply rules to service providers that are covered by the general interest⁹, and have not been observed already in the home country (Hailbronner/Nachbaur 1992: 112).

⁸ Even if there is a certain visible product, such as an insurance policy, it is not this material form but the invisible behind it (i.e. the risk calculation) which constitutes the relevant service (cf. Vahlens Großes Wirtschaftslexikon (2. edition), keyword “Dienstleistungen”).

⁹ Restrictions on services parallel restrictions on goods: the mandatory requirements established with the *Cassis* judgment were antedated by the “general interest” established in the *Van Binsbergen* (C-33/74) judgment of 1974.

The general good doctrine must be seen as the necessary counterweight for the Court's judicial activism in widening the scope of the Treaty freedoms from mere non-discrimination principles to general prohibitions on all measures, whether discriminatory or not, which constitute a *restriction* to free movement across borders (Tison 2002: 323, emphasis in the original).

The general good doctrine may restrict the freedom of services beyond the restrictions on temporary activities. An example for this is the posting of workers which falls under the freedom to provide services. The ECJ decided this being called upon in the case *Rush Portuguesa* (C-113/89). France had tried to limit the influx of Portuguese construction workers under the freedom of movement. However, the ECJ gave Member states the right to apply to posted workers their national wages and labour law – labour could be imported but Member states were free to determine that this would have to be under their domestic conditions, thus eroding the competitive advantage of low wages. This, is of course, not what one would have thought, given that the freedom of services – due to its temporary nature – shall not be burdened with too many rules of the host country. But the ECJ found that Member states could act this way under the general interest.

Following the ruling, France enacted a national law for posted workers. The other Member states affected by the problem followed. Though the Commission had started early to try to coordinate these activities through a directive, this was agreed in the Council only in 1996 after the national laws existed. For the Member states, there had been few incentives to agree on harmonisation, given that the ECJ had given them large leeway for national treatment. The directive therefore only gives a framework for the national laws by establishing some common principles of mutual recognition.

The example of the posting of workers shows that there are many reasons to apply host-country rules also to the temporary provision of services. Otherwise, there would be a situation where workers in high-wage countries would be out-competed on their own soil. Also for temporary activities, the posting workers directive allows to require the wages and working conditions of the host country.¹⁰

3.2 Interpreting EC state aid law

The interpretation of EC state aid law can be described as a constant struggle of the Commission in order to tighten its control of member states' aid policies while guarding a maximum degree of its own policy autonomy (Smith 1998; Smith 2001). Notwithstanding the considerable competencies of the Commission already provided for in the Treaty of Rome, a stricter system of European state aid control only evolved since the mid-1980s, closely related to the formation of the single market programme (McGowan 2000: 131). Since then, the Commission has, supported by ECJ rulings, developed an increasingly rigorous system of soft law and some secondary legislation. By taking this rules-based approach, the Commission not only tried to tighten EC state aid control, but also to shield its own autonomy from political pressures from member states in individual cases.

At the same time, however, this progressive codification of EC state aid control practice created new potential constraints on the Commission's autonomy. As M. Smith has shown, the Commission has increasingly become confronted with demands for action or with challenges

¹⁰ However, Germany, which does not have a minimum wage and implemented the posting workers directive only for construction workers, faces exactly this situation after Eastern enlargement, for instance in the meat industry.

to its decisions on the part of third parties. Hence, the Commission's autonomy to focus on particularly important cases and to keep certain issues off the agenda became threatened and it had to struggle with growing workload (Smith 2001: 202f.). Moreover, codification always involves a self-restriction of the Commission's discretion. While the Commission has an interest in self-limiting its autonomy in order to be less vulnerable to taking 'political' decisions, it runs the opposite risk of too 'legalistic' or inflexible treatment of individual state aid cases. Hence, if the Commission wants to be able to account for special characteristics of particular cases and new developments in state aid policy, and given the fact that changing existing rules or adding new rules is a rather intricate and time-consuming process, codification must allow for a certain degree of flexibility.

Although European state aid law is seen by lawyers to have 'come of age' (Hansen/Van Ysendyck/Zuhlke 2004) and a large share of state aid cases today are rather simple applications of well-established rules (Wolf 2005: 111), EC state aid control has not become a pure technical exercise. There are still major areas where the described balancing processes have led to more ambiguous state aid rules, and given the often complex economic and political nature of these issues, this is unlikely to change in the short or medium-term.

Following the structure of state aid Treaty law, the Commission's ongoing efforts to tighten EC state control while keeping its own autonomy, can be clustered into three parts: (1) the scope of what is covered by EC state aid control (Article 87(1) of the EC Treaty) is widened; (2) the exemptions from the general state aid prohibition (Articles 87(2) and 87(3)) are defined more narrowly; (3) enforcement of existing state aid rules (Article 88) is strengthened.

(1) The term 'state aid' has to be understood in a broader sense than 'subsidy'.¹¹ Based on this extensive interpretation of Article 87(1), "there has been a discernible trend in recent years to invoke the Community's rules on State aid in certain sectors in which the role of the State has traditionally been predominant, including public broadcasting, postal services, medicine, education, and taxation" (Plender 2003: 5). In the field of taxation, for example, the Commission has come to interpret Article 87(1) very broadly and thus, to interfere heavily into domestic tax policies, while keeping considerable room for manoeuvre for itself. The fundamental distinction between specific tax measures arising from 'the nature or general scheme' of the national tax systems, not constituting state aid, and other selective tax measures, involving state aid, is far from clear-cut. While some welcome the Commission's efforts as legitimate support in the struggle against harmful tax competition (Schön 1999: 912), others blame the Commission for diverting state aid rules from their intended use and for causing confusion by interfering into issues of economic sovereignty (Quigley 2003: 207).

Another area where the interpretation of Article 87(1) is crucial, are the services of general economic interest (SGEI, Article 86(2)). In its recent *Altmark* judgment¹², the ECJ has ruled that compensation for SGEI does not constitute state aid, provided that certain conditions are met. These conditions, however, being quite demanding to fulfil and difficult to assess, particularly if the amount of compensation has not been established by an open public tender, the Commission had to fear becoming confronted with increasing complaints by third parties and an "avalanche of notifications under Art. 88(3), thereby placing Commission state aid en-

¹¹ "The concept of aid is nevertheless wider than that of a subsidy because it embraces not only positive benefits, such as subsidies themselves, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without, therefore, being subsidies in the strict meaning of the word, are similar in character and have the same effect"; Case 30/59, *De gezamenlijke Steenkolenmijnen in Limburg* / ECSC High Authority [1961] ECR 1, p.19.

¹² Case C-280/00, *Altmark Trans*, [2003] ECR I-7747.

forcement under severe strains” (Hansen/Van Ysendyck/Zuhlke 2004: 203). Recent Commission measures¹³ have to be understood as a response to these fears, trying to keep small-scale public services outside the reach of EC state aid control in order to concentrate Commission resources on the control of important cases.

(2) The current State Aid Action Plan, presented by Commissioner Kroes in July 2005, places EC state aid control into the context of the Lisbon Agenda and sets the goal of ‘less and better targeted’ state aid (European Commission 2005a). Both aspects, ‘less’ and ‘better targeted’ relate to a narrower definition of what may be considered state aid compatible with the common market according to Article 87(3). The first aspect, the overall reduction of aid levels, is an ambitious target that has not been met during recent years (European Commission 2005b: 4f.) and that seems, at least in practice, not to be supported by all member states. Even though the second aspect, the redirection of state aid towards objectives of common interest is less contested and an according trend can be observed (*ibid.*), the Commission’s policy meets the resistance of certain member states. The example of regional aid helps to illustrate both aspects. The new multisectoral framework that entered into force in January 2004 aims to substantially reduce aid for large investment projects. It has been criticized for impacting heavily on national regional policies and for leaving little or no room for flexible treatment of individual cases (Soltesz 2005: 105f.). Original plans for a revision of the regional aid guidelines presented in April and December 2004¹⁴ not only aimed at an overall reduction of regional aid levels but also at concentrating regional aid in the economically least developed regions in order to improve Community cohesion. This would have meant a substantial reduction of regions eligible for regional aid compared to the current guidelines and met the resistance of those states that would have been particularly affected. Thus, despite general agreement on ‘better targeting’ state aid, several unresolved conflicts between the Commission and EU member states as well as between different Commission goals arise. First, the burden of proof in EC state aid control is increasingly shifted towards the member states. While the Commission almost automatically assumes any state aid measure to have a potentially distortive effect (Wishlade 2003: 10), member states have to justify national state aid policies in order to meet the Commission’s efficiency criteria of ‘well targeted’ aid.¹⁵ Second, it is questionable to what extent EC state aid law authorizes the Commission to direct national state aids to certain ‘good targets’ defined by the Commission itself. While the Commission argues positively to place EC state aid control in the context of the Lisbon Agenda, others might criticize this as an instrumental use of state aid law, not aiming primarily at undistorted competition but at furthering other Community policies such as cohesion policy or research and development policy. Third, the Commission’s different goals in EC state aid control are not always coherent. Thus, inconsistencies between the goals of competition and cohesion have been noted (Schindler 2005: 83) as well as between competition on the internal market and competitiveness on a global level (Soltesz 2005: 105).

(3) Finally, the Commission’s efforts to strengthen the compliance with existing state aid rules centres on the issues of notification and of recovery of illegal aid. Most Commission measures in this field can be subsumed under what compliance researchers have labelled

¹³ See Commission Press Release IP/05/937, July 15, 2005, State Aid: Commission provides greater legal certainty for financing services of general economic interest.

¹⁴ For an overview of the different draft documents, see (Battista 2005).

¹⁵ In the State Aid Action Plan, it is argued that state aid compatible with the common market should not only be ‘achieving its objective’, but even be ‘the best type of state intervention for any given objective’ (European Commission 2005a: 13).

‘management approach’ on the one side and ‘enforcement approach’ on the other side (Tallberg 2002). The management approach comprises measures such as the development of standard notification forms, the promotion of knowledge on EC state aid control, or the recent idea of a network of national state aid authorities for a better exchange of information and of best practices. The main enforcement instrument of EC state aid control is the decision to recover illegal or incompatible aid. DG Comp has recently set up an enforcement unit, primarily concerned with the implementation of these recovery decisions. Hence, on a more technical level, the Commission is concerned with making state aid control more effective while keeping workload under control, e.g. by exempting certain forms of state aid from the notification requirement. However, even in this seemingly least problematic area of rule application, politically sensitive issues arise. Asymmetries in knowledge on EC state aid law, presumably more pronounced in the new member states, may be exploited by higher authorities vis-à-vis lower levels of government. Threatening local authorities with the prospect of Commission control might discourage them from implementing state aid measures even if these would pass the Commission’s compatibility test. Moreover, legal uncertainty and the risk of recovery decisions might deter potential investors or purchasers of businesses from dealing with state aid beneficiaries. Awareness of these risks has risen and this holds particularly for many privatisations and acquisitions in Central and Eastern Europe (Hansen/Van Ysendyck/Zuhlke 2004: 45).

To sum up, based on articles 87-89 of the EC Treaty, a highly complex and elaborated system of EC state aid control has evolved, mainly through Commission practice and soft law, supported by ECJ rulings and only recently complemented by secondary legislation. This development, however, has not resulted in EC state aid control being less ‘political’ today – by contrast, by getting more and more rigorous and comprehensive, EC state aid control increasingly touches upon issues of traditionally national policies.

4. Outlook

As we have seen, the mutual recognition of goods and particularly services and the control of state aid in many ways constrain domestic economic policy-making. This may be a particular problem for new Member states with their still fragile economies, the particularities of which European Treaty law and the *acquis communautaire* are not adapted to. In the area of state aid policies, for example, the new Member states still struggle with their communist legacies of state intervention and the financial difficulties of formerly state-owned enterprises that are still in the process of restructuring. The Commission faces the dilemma of accommodating these needs of the new Member states while at the same time having to ensure the uniformity of European law.

But to the new Member states the situation is an ambiguous one. Due to the recent transformation of their political and economic systems, the new Member states in many respects are also better situated than the old Member states to meet European obligations. For example, the new Member states tend to have lower regulatory standards in non-harmonized policy areas, potentially giving them a competitive advantage vis-à-vis the old Member states. However, due to these differences between the old and new Member states, the preconditions for the proper functioning of mutual recognition, relative similarity of regulations and mutual trust in the application of standards, may be undermined. For our future work it is important to understand how the increased heterogeneity among Member states affects the working of mutual recognition and the control of state aid.

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