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**Emerging Regulatory Challenges
to the EU's External Economic Relations**

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Emerging Regulatory Challenges to the EU's External Economic Relations¹

Peter Holmes and Alasdair Young

Introduction

This paper focuses on the challenges posed to the European Union's external economic policy by the changing nature of the multilateral agenda and by the tensions emerging in the EU's own approaches to market integration. These challenges are multifaceted and interactive. They are both compounded and thrown into stark relief by the process of enlargement to the countries of central and eastern Europe (CEECs).

Particularly with and since the Uruguay Round of General Agreement on Tariff and Trade (GATT) negotiations, the multilateral trade agenda has begun to tackle seriously 'behind-the border' barriers to trade in goods and services, such as regulations. Combined with the introduction of a binding dispute settlement mechanism this has made the multilateral system qualitatively more challenging to sovereignty. At the same time as the multilateral system is flirting with going beyond national treatment – witness the Sanitary and Phytosanitary (SPS) Agreement, the aims of the Multilateral Agreement on Investment (MAI) negotiations and the discussion of multilateral competition rules – the EU is encountering limits to mutual recognition. The process of extending the EU model of market integration to the countries of central and eastern Europe exacerbates the latter challenge and compounds the former.

¹ We gratefully acknowledge the support of the European Commission Education Directorate. The opinions expressed here are those of the authors' alone. We also thank Seamus O'Cleireacain and Sam Laird and the other participants of the Workshop on 'Challenges for EU External Economic Policy in the Next Decade' (13-14 April 2000) and the 'The Political Economy of Change and Adjustment in Europe' Conference (6-7 July, 2000) for their comments an earlier version of this chapter.

We begin with a general discussion of why eliminating technical barriers to trade (TBTs) is fundamentally more difficult than reducing tariffs and of the implications for national sovereignty of different methods of market integration. This leads to a discussion of the limits that the EU is beginning to experience in its own internal process of liberalisation. We then turn to the challenges posed to the EU by the development of the multilateral system, before examining how eastern enlargement will impact on both sets of challenges. We conclude by identifying some of the implications of our analysis for EU foreign economic policy.

LIBERALISATION VERSUS REGULATORY SOVEREIGNTY?

Divergent national regulations can and do pose barriers to trade. Eliminating such barriers, however, is fundamentally more challenging to national sovereignty than reducing tariffs, because most regulations serve legitimate and necessary purposes. Consequently, they cannot simply be swept aside. Squaring the circle by replacing divergent national rules with common rules, as even the EU has discovered, is fiendishly complicated and time-consuming, at best; and at the multilateral level probably impossible. In the absence of common multilateral regulations, how can the tension between liberalising trade and addressing market failures be satisfactorily addressed?

The problem exists because there are a number of legitimate reasons for national regulations to diverge (Hancher and Moran, 1989; Previdi, 1997). First, and most straight forward, different countries face different problems. This naturally results in different policy responses.

Second and more fundamental, there are cultural differences in attitudes towards risk. When devising rules for assessing the safety of substances no formula will be perfect. There is the double-edged risk of mistakenly banning something that is quite safe or of mistakenly

permitting something dangerous. No test is perfect. Statisticians distinguish between 'Type I' and 'Type II' errors, i.e., falsely rejecting a correct hypothesis vs. falsely accepting an incorrect one. They tell us that for any given amount of evidence you cannot reduce the risk of one type of error without increasing the risk of the other. The choice on the trade off depends on subjective preferences regarding the consequences of error, the 'loss function' (see Bernstein, 1996). Where these differences are cultural, as we contend they are at least in part, national regulatory frameworks will be set such as to opt for more of one or other risk. The US, and to a lesser extent the UK, tend to err on the side of the putting burden of proof on those who want to act, and thus require high levels of scientific proof before introducing regulations. Denmark and Germany, however, are more concerned about the potential risk of the new and tend to place much greater emphasis on the 'precautionary principle' (Héritier 1994).²

Third, even if two countries face the same problem and have the same attitude to risk, politics would produce different outcomes (Hancher and Moran, 1989; Pollak 1998). As different countries (including the EU) have different constellations of societal interests and different political institutions, the political interplay between them would be expected to produce different regulatory outcomes.

Given the legitimate bases for differences in national regulatory approaches, the question arises how the multilateral system should cope with the tension between trade liberalisation and regulatory sovereignty (Jackson, 2000). The EU and the international system both face trade offs between the risks of allowing national bans that are ostensibly for consumer protection, but actually are sheer protectionism (letting a guilty person go free) versus the danger of preventing countries banning products merely because their collective preferences are different (convicting an innocent). This tension is evident in the current

² There is no risk minimising free lunch here as attention paid to any one risk may distract from another (Jaynes

transatlantic dispute of hormone-treated beef and was a factor in the collapse of the MAI negotiations in 1998 (Young, 2000). Different national attitudes and approaches to risk are particularly difficult to reconcile. The challenge is how to distinguish between regulations that are merely protective and those that are protectionist.

Even leaving these considerations aside, the removal of TBTs is also arguably more politically difficult to sell domestically. Changing or removing a regulatory measure does much more than affect the price of competing imports, as is the case with tariffs. It may well affect the production requirements for even non-trading firms. Further, while tariff reductions bring unalloyed gains to consumers in lower prices, trade liberalisation through easing of regulatory barriers may involve exchanging price for safety. Both of these factors, arguably, make finding the political trade-offs between importers and exporters much more difficult.³

MARKET INTEGRATION AND GOVERNANCE

There are essentially five modes of market integration (see Table 1). The most-favoured nation (MFN) principle, which underpinned the early success of the GATT in removing tariff barriers, is essentially irrelevant in the context of technical barriers to trade. National treatment (NT) is another long-established principle of the GATT. While directly relevant to regulatory barriers, as it forbids foreign products or services being held to a different (higher) standard than domestic products or services, it does not prevent national rules from being structured in such a way that they de facto privilege domestic production. As a consequence, the EU found it desirable to move beyond NT with the single European market programme and the members of the WTO have moved beyond NT with respect to at least trade in agricultural and food products with the Sanitary and Phytosanitary (SPS) Agreement.

Table 1 Modes of market integration

<i>Mode of market integration</i>	<i>Meaning</i>
Most favoured nation (MFN)	Can discriminate against but not between foreigners
National treatment (NT)	Treat foreign and home firms equally but rules can be idiosyncratic
Mutual recognition (MR)	Accept foreign standards, but assumes equivalence, which is contestable
Reference to standards	Agreed regulatory objectives plus reference to voluntary standards (may or may not be common)
Harmonisation/approximation	Everyone has same/similar rules (includes international standards)

The principle underlying mutual recognition (MR), an approach that the European Commission developed on the basis of European Court of Justice case law, is that although national requirements may differ in substance they are equivalent in effect. In such circumstances, although the specific requirements to which a product has been produced may differ between countries, they convey comparable levels of protection and therefore can be accepted at no cost to consumer safety without need for further agreement. This approach gives national governments significant leeway in adopting their own rules, but may be quite intrusive in terms of sovereignty by requiring them to accept products produced elsewhere. How intrusive mutual recognition is to sovereignty depends on whether governments have a say in whose products or services they consider equivalent.

Under the 'reference to standards' approach expert, non-governmental standards bodies (see Table 2) agree voluntary standards. National governments are supposed to draw on these standards when adopting their own and should deviate from them only if they are not adequate to perform some legitimate regulatory function.

³ We are grateful to Prof. Paolo Guerrieri for this point.

Table 2: International independent standard setting bodies

<i>Subject regulated</i>	<i>EU body</i>	<i>Multilateral body</i>
Non-electrical industrial products	CEN	International Organisation for Standardisation (ISO)
Electrical products	CENELEC	International Electrical Commission (IEC)
Telecommunications equipment	European Telecommunications Standards Institute (ETSI)	International Telecommunications Union (ITU)
Food products	---	Codex Alimentarius

The final mode of market integration is approximation or harmonisation in which governments collectively agree common rules. These rules must be applied in each of the participating countries. Depending on the decision rules in play, every government may have to agree to each rule or those in a minority might be forced to accept rules that they dislike.

A crucial issue, and a profound implication of the Uruguay Round, is that the implications for sovereignty of each of these modes of market integration depend fundamentally on the mechanism for resolving disputes about the compatibility of national requirements with international agreements. Where there is no recourse to binding dispute settlement none of these modes impinges too sharply on regulatory sovereignty. If a government adopts rules that de facto but not de jure discriminate against foreigners, or rejects out of hand all products produced in conformity with foreign regulations, or consistently ignores international standards without justification, the aggrieved can do little but complain. Even common rules have little implication for regulatory sovereignty unless there is some mechanism to enforce implementation.

We shall now turn to how these modes of market integration have been developed and deployed in the EU and increasingly at the multilateral level. In the next section, we pay

particular attention to the tensions that have emerged between market integration and regulatory sovereignty within the EU. We will then turn our attention to how the development of the multilateral system has compounded these tensions.

THE EU'S INTERNAL CHALLENGES

Market Integration the EU Way

Not surprisingly, the more intensive forms of market integration – mutual recognition, reference to standards and regulatory approximation – are more highly developed within the EU than anywhere else in the world. It is worth therefore briefly summarising the EU's approach to market integration before addressing, later in this section, its internal challenges and in subsequent sections the external challenges posed by the deepening of the multilateral system and enlargement.

The starting point of European market integration is the 1957 Treaty of Rome. It established the core principles of non-discrimination and the free circulation of goods, services, capital and people, albeit crucially within certain bounds (see Table 3). Significantly, however, national rules, at least in part because they addressed valid public policy objectives, could not simply be swept away by the application of Treaty principles. Consequently, secondary legislation, which introduced a degree of regulatory approximation, had to be adopted in a number of areas. Thus John Pinder's (1968) distinction between 'negative' and 'positive' integration, while analytically useful, is overly stark: the removal of national technical barriers to trade often requires at least some approximation. The EU has thus made use of all of the modes (except MFN) of market integration discussed above.

Goods

Following the creation of the customs union in 1968, it became evident that TBTs remained as the most significant obstacles to free trade. Most of these rules, however, safeguarded legitimate public policy objectives and so could not simply be eliminated. The Commission's initial response was to seek to agree detailed common rules to eliminate the awkward national differences that impeded trade. This proved extremely cumbersome, slow and ultimately unsatisfactory (Dashwood, 1983).

In the early 1980s the EU changed tack. The Commission, building upon the ECJ's *Dassonville* and *Cassis de Dijon* judgements, advanced two core innovations — the mutual recognition principle and the 'new-approach' to harmonisation — which paved the way for the single European market (SEM) programme (Young and Wallace 2000a). As mentioned above, the mutual recognition principle assumes that although the member states' rules might differ in substance, they should be considered to be equivalent in effect, unless an importing state could demonstrate otherwise. Consequently, the default scenario is for the member governments to accept products legally on sale in other member states.

The mutual recognition principle applies to products accounting for approximately 25 percent of industrial production (Commission, 1996b). This indicates that, even within the relatively homogenous club of countries that is the EU, only a relatively small proportion of national regulations can be assumed to be equivalent in effect.

As a consequence, the EU has frequently had to turn to regulatory approximation in order to achieve market integration. The least intrusive mode of regulatory approximation is the so-called 'new approach'. Under this approach, the European political institutions confine themselves to agreeing common 'essential minimum requirements,' which tend to establish only ends, not the means of achieving them. Developing detailed specifications to meet these requirements is delegated to the European standards bodies — CEN, CENELEC

and ETSI. Even the resulting European standards, although bringing advantages, are not mandatory; any standard that is certified as meeting the essential minimum requirements can circulate freely within the EU. Products falling under the new approach directives — such as toys, construction products, pressure vessels and recreational craft — account for about 17 (and growing) percent of EU industrial production (Commission, 1996b).

Detailed harmonisation is restricted to relatively few products — most notably cars and chemicals — that are regarded as particularly dangerous. There are also centralised authorisation procedures for pharmaceuticals. Genetically modified crops and foods are subject to a common, but decentralised approval process. Although restricted to relatively few product groups, because of their economic importance, detailed harmonisation affects products accounting for about 30 percent of industrial production.

Services

There are two particular aspects to services that make transnational liberalisation particularly challenging: they are often subject to high levels of domestic regulation and often the provision of services requires the physical proximity of supplier and consumer and, thus, often involves establishment. The EU, as did the General Agreement on Trade in Services (GATS) (see below), makes a distinction between the cross-border supply of services and those involving establishment. We shall follow their lead and focus here on the cross-border provision of services, including establishment in our discussion of investment, below.

The general provisions of the Treaty on the freedom to provide services, right of establishment and non-discrimination were sufficient to liberalise most services. There were relatively few service sectors -- financial services, transport, telecommunications, broadcasting and advertising, and some professional services – in which detailed secondary legislation was required (Commission, 1996b). These sectors fall into essentially three

groups: 1) those in which market access was quantitatively restricted (transportation, telecommunications); 2) those in which national rules were sufficiently cumbersome that national treatment was still de facto discriminatory (financial services, broadcasting, advertising); 3) those for which mutual recognition of professional qualifications was not accepted without some agreed minimum standards (doctors, architects, etc.).

European regulation liberalised cross-border provision of transport services, in all but rail, by eliminating quantitative restrictions and price controls, replacing them with common qualitative criteria and safety measures. This is roughly analogous to negotiated mutual recognition on the basis of national rules incorporating agreed minimum essential requirements.

The liberalisation of professional services has proceeded on largely on the basis of mutual recognition. Some framework directives have established general procedures for mutual recognition of most professional qualifications. These procedures are not automatic and involve the evaluation of qualifications. For some professions, particularly those in healthcare, but also architects, profession-specific directives have been agreed that establish common minimum requirements.

Negotiated mutual recognition also underpins the liberalisation of financial services in the EU (Müller 1999). The centrepiece of market integration in financial services was approximation of national prudential regulations (minimum essential requirements) combined with 'home-country control' (mutual recognition of regulatory authority). Under this system, with the exception of some aspects of personal life insurance, the EU-wide operations of a financial institution — whether provided across borders or through establishment — are regulated by the government of the state in which it has its headquarters.

The move to liberalise telecommunications services in the EU came only in the late 1980s, and thus, more than in any other sector paralleled multilateral developments (Young,

2000). The key to liberalising cross-border telecommunications services was abolishing discriminatory conditions for access to the existing network. The most important measures liberalising telecommunications, however, concerned establishment and competition policy, to which we now turn.

Investment

Unlike with goods and services, there has been relatively little secondary legislation implementing the EU's internal investment regime, which is based almost entirely on the right of establishment enshrined in the Treaty of Rome (Brewer and S. Young, 1995). Nonetheless, some common rules have been necessary to ensure the free flow of investment between member states. The most important of these concern the liberalisation of capital movements, the abolition of exchange controls and the establishment of basic conditions with respect to financial, transport and telecommunications services, mentioned above.

Prior to the SEM programme, transport was the only sector to which the right of establishment did not apply. The SEM, however, created common definitions of European firms and established frameworks that enabled them to operate freely throughout the EU. Establishment in financial services was less of a problem, although it did require a national licence for each member state in which operations were conducted and sometimes licensing conditions were discriminatory. The establishment of 'home-country control,' described above, addressed both of these problems.

In telecommunications, common rules were adopted to eliminate exclusive rights on mobile, data and satellite services and, more recently, basic telecommunications. The 1998 package of liberalisation measures requires: objective, transparent and non-discriminatory licensing of network operators and service providers. Although various conditions, such as ensuring universal service, may be attached to licences, the number of licenses available

cannot be limited except where necessary for technical reasons. Particularly relevant for our purposes, is the regulatory framework to ensure that competitors have access to and interconnection with the network on reasonable terms. This regime, established by the EU's 1995 open-network provision directive,⁴ provided the model for the GATS 'Reference Paper' on anti-competitive behaviour (Holmes, Kempton and McGowan, 1996.)

A wide range of non-investment-specific European rules also affect cross-border investments within the EU. The works-council directive and merger control regulation,⁵ for example, apply only to firms with operations in more than one member state. Other rules, such as controls on state aids (subsidies), rules on regional aids, the work-time directive,⁶ and environmental measures affect foreign investment as well as domestic firms.⁷

Competition policy

EU competition policy (Treaty of Rome, Articles 81-89 (ex 85-94)) does not target inefficiency or harm to consumers *per se* but measures and actions that 'distort trade between member states.' The objective is to ensure that as tariff barriers and other state-controlled border measures disappear they are not replaced by subsidies or by various forms of market entry barriers put in place by private or state-owned firms. Thus, the Treaty targets cartels that enable the fragmentation of the European market and abuses of dominant position that allow a firm in one market to rip-off consumers while preventing rivals from elsewhere entering its home market. Rapacious abuses that do not affect trade are acceptable.

This explains the emphasis in the initial years of EU competition policy on the removal of vertical restraints — such as restrictive selective and exclusive distribution agreements — which allowed producers to segment (national) markets. As the single market

⁴ Council Directive 90/387/EEC, *Official Journal of the European Communities*, L 192, 24 July 1990.

⁵ Council Directive 94/45/EC, *Official Journal of the European Communities*, L 254 30 September 1994, Council Regulation 4064/89/EEC, *Official Journal of the European Communities*, L 395, 30 December 1989

⁶ Council Directive 93/104/EEC, *Official Journal of the European Communities*, L 307, 13 December 1993.

became a reality, EU strengthened its application of competition rules — most clearly by adopting the 1989 mergers directive, which gave the Commission authority to vet mergers that might affect the common market — lest firms respond to the completion of the single market in ways — such as pan-European mergers, cartels, and market sharing arrangements — that would frustrate the intensification of international competition. We should note that within the EU state aids are treated as part of the competition policy process, as an element of ‘levelling the playing field’ . The EU thus distinguishes between trade distorting subsidies and those intended to encourage desirable activities (e.g., those pre-competitive collaborative R&D, environmental protection and regional development).

Intellectual Property Rights

Intellectual property rights provide a unique example of the limits of European market integration. Although, the subject of intellectual property rights is a vast and highly technical one and in a paper of this kind we cannot hope to cover the whole field, we shall in this section and below highlight the difference between the EU’s approach internally and at the multilateral level.

The Treaty of Rome did not bestow competence for intellectual property on the EU. In fact Article 295 (ex 222) asserted that “The Treaty shall in no way prejudice the rules in Member States governing the system of property ownership which has been taken to include Intellectual Property” In addition, Article 30 (ex-36) included “the protection of industrial and commercial property” among the legitimate exceptions to free trade.

In 1968 in the *Parke-Davis vs Centrafarm*⁸ case the ECJ declared that “... national rules relating to the protection of industrial property have not yet been unified in the Community,” whilst regretting this fact. The problem of course is that different national rules

⁷ See Brewer and S. Young (1995) for a full description of EU policies with implications for FDI.

sustain the ability of firms to segment the single market by, for example, exclusive distribution arrangements

Over time the EU has moved very slowly indeed towards a common framework for intellectual property rights, but has addressed the ensuing problems through the indirect and somewhat delicately balanced method of applying competition law to ensure that separate national systems did not allow firms to exercise their rights (which were not removed) in such a way as to create barriers to trade within the single market. The Commission has thus taken a tough line on exclusive and selective vertical agreements.

In addition, the Court developed the doctrine of “Community-wide exhaustion.” This means that even where a trade mark, patent or license is held by different parties in different EU markets, traders from one member state are free to buy from any of the different sellers anywhere in the EU. By contrast, the Court has ruled that intellectual-property-right holders may use their control over sales to prevent goods legally purchased outside the EU from being imported into the EU and resold, even where the existence of a price differential indicates the possible presence of market power within the EU.

Developing a common EU intellectual property framework through legislation has proved difficult. Intellectual property rights were not included in the Treaty of Rome, thus there has been no institutional push for approximation. This exclusion and subsequent lack of progress also reflect the ‘path dependence’ of national traditions (Lerner, 2000). The European Patent Convention is not an EU body, although all 15 member states are now members, along with Cyprus, Liechtenstein, Monaco, Switzerland, and Turkey. Consequently, it is outside the formal EU legal framework. A proposal to transpose into EU law, as opposed to national law, the copyright provisions of the Berne and Rome Conventions

⁸ Case 24/67 Parke-Davis vs Centrafarm [1968] *European Court Reports* 55.

of the World Intellectual Property Organisation is working its way through the EU's decision-making procedures. Trade marks and some aspects of copyright, especially on software, do fall under EU law.

The approximation of national intellectual property regimes in the EU, therefore, as elsewhere, has been driven by international not EU agreements and intellectual property rights remain enforceable largely through national courts. Strikingly, as we shall see, the EU member governments agreed during the Uruguay Round to subject themselves to disciplines they had not agreed within the EU framework.

Internal regulatory challenges

The EU's accomplishments with regard to market integration are undoubtedly impressive. Even leaving aside the thorny issues of intellectual property rights and taxation, however, one cannot consider the EU to be a truly single market; a number of significant regulatory trade barriers continue to impede trade among the member states (although the same can be said of the US domestic market). The central reason for this is that the EU has from the outset accepted legitimate restrictions on trade. These are most explicitly stated in Article 30 (ex 36) of the Treaty of Rome (see Table 3).

As a consequence, the application of the mutual recognition principle, particularly the assumption of equivalence, has been disputed successfully numerous times before the ECJ. Significantly, the ECJ has not required governments to provide conclusive proof that a product would harm human health before it can exercise its prerogative under Article 30 (ex. 36) to refuse to accept a product legally on sale in another member state (Weatherill and Beaumont, 1993). This was illustrated in the *Eyssen* case, in which the Dutch government's ban on the preservative nisin in processed cheese was upheld even though existing scientific evidence on the health risk of nisin was equivocal. The ECJ took the view that a government

is entitled to protect its public from substances the safety of which is subject to scientific doubt. In other words, application of the precautionary principle is sufficient to justify action under Article 30 (ex 36).

Legitimate restrictions aside, mutual recognition does not appear to be working as well in practice as it should in principle (Commission, 1999c). The problem is particularly acute with respect to foodstuffs, electrical engineering, construction products, cars, financial services and professional qualifications. In part this underperformance is attributed to citizens and firms not fully appreciating the power of the principle, but government administrations also appear to have problems assessing the equivalence of degrees of protection. The Commission, with the Council's (1999a) blessing is embarking on a campaign to educate citizens and firms and to develop, through administrative cooperation, methodologies for assessing equivalence.

There have been problems with the practice of other modes of market integration as well. The 'new approach' to approximation is challenged both by the slow adoption of European standards implementing agreed minimum requirements and by the much higher number of national standards adopted. Between April 1998 and May 1999 the European standards bodies ratified only 40 per cent of the mandated standards (Commission 1999c). Nearly five times as many national standards as European standards were adopted in 1998 (Commission 1999c). This suggests that differences among the member states with regard to the specifics of regulation remain pronounced and are difficult to overcome.

Even when common EU product standards have been adopted, it is possible, under certain circumstances and with the prior approval of the Commission, for member governments to impose more stringent national standards under Article 95 (ex 100a). This provision was included in order to address the Danish and German governments' concern that single market rules adopted under qualified majority voting, with them in the minority, might

force them to accept products that they consider unsafe or environmentally harmful (Ehlerman 1987). This was underlined by Denmark's (not legally binding) Declaration in the Single European Act to the effect that

... in cases where a Member State is of the opinion that measures adopted under Article [ex-]100a [single market measures] do not safeguard higher requirements concerning the working environment, the protection of the environment or the needs referred to in Article [ex-]36, the provisions of Article [ex-]100a4 guarantee that the Member State in question can apply national provisions.

According to the Commission (1996a), governments invoked ex-Article 100a(4) most often in the chemical sector. As far as we know, the only legal challenge to a national rule adopted under ex.-100a4 to have been concluded is the French government's challenge of the Commission's approval of Germany's ban on PCPs. The ECJ, in 1994, overturned the Commission's approval of the ban on procedural grounds.

The Treaty of Amsterdam substantially modified Article 100a(4) (and renumbered it 95). These changes require the member government to notify the Commission of the reasons for maintaining the provision, but also permit member governments, with the permission of the Commission, to *introduce* national provisions based on new scientific evidence after the adoption of common measures. Thus the EU, while permitting greater national autonomy, has introduced procedural requirements to in an attempt to ensure that new measures are not disguised protectionism. This approach echoes the emphasis on scientific evidence that adopted at the multilateral level, particularly with respect to the SPS Agreement.

One recent high profile example of different national attitudes and approaches to risk within the EU is the French and German governments' refusal, partly on scientific grounds, not to accept British beef because of continuing concern about BSE, despite British beef being cleared by the EU-level veterinary authorities. As recent developments in ECJ jurisprudence may reflect an easing of the emphasis on market integration over national

sovereignty particularly where uncertainty about safety is concerned (Weiler, 1999), it is far from certain that the ECJ will overturn the French and German bans on British beef imports. The issue is gaining in importance as other member governments and subnational governments impose bans on French beef after an increase in cases of BSE there. An EU measure providing for testing beef imports for BSE is due to come into force from 1 January 2001. A crucial feature of the EU's regulatory approach is that, despite having engaged in a greater degree of regulatory approximation than any other group of countries, a significant degree of variation between national rules is permitted (Young and Wallace, 2000b). In fact, progress on market integration within the EU has been possible only because the approach has acknowledged and respected the member governments' prerogative to pursue legitimate public policy objectives, even at the expense of interfering with the four freedoms (Young and Wallace, 2000b). The EU today is thus encountering a logical limitation: market integration is possible only if legitimate national variation is tolerated, but national variation impedes market integration. Further, as market integration progresses the national variations that remain are likely to be the most fundamental and intractable.

CHALLENGES POSED BY THE MULTILATERAL SYSTEM

General challenges

The Uruguay Round (1985-93+) of multilateral trade negotiations moved the multilateral system in significant ways towards 'deeper integration' which had previously been associated with the EU model. In particular it:

- extended the breadth and depth of coverage – going further 'beyond borders,' and including agriculture, services and intellectual property

- introduced 'binding' dispute settlement, under which a WTO member can no longer veto the adoption as WTO law of a decision against it;
- and introduced a degree of mutual recognition and approximation (e.g., SPS and TBT).

In addition, as a consequence of the introduction of binding dispute settlement, the national treatment obligations under Article III potentially acquire greater significance as de facto (as well as de jure) discrimination can be challenged effectively.

Given the difficulty of agreeing fine details in multilateral negotiations (the familiar problem of 'incomplete contracting'), the dispute settlement mechanism has been left to weigh trade liberalisation against other, non-economic policy objectives. This raises interesting parallels with the development of ECJ-driven integration within the EU. It is clear, however, that making the dispute settlement system 'binding' is quite a different matter from the supremacy of EU law.

We shall now briefly review the main changes to the multilateral system introduced by the Uruguay Round.

Goods

Historically, the GATT sought to freeze ('bind') and periodically reduce tariff barriers and to replace quantitative restrictions (QRs) with tariffs, which were then subject to reduction. The notion of a QR under the GATT was much less sweeping than the Treaty of Rome's inclusion of 'measures having equivalent effect.' In addition, the 1947 GATT had no provisions for harmonising laws in order to ensure free trade.

Starting with the 1979 Tokyo Round Agreement, however, the multilateral system began to impose disciplines on national regulations that impeded trade — TBTs. This was challenging as the GATT, even more than the EU, had to recognise the diversity of policy and

market structures. Nonetheless, its members sought above all to ensure that whatever systemic diversity existed did not have discriminatory effects on trade. Thus it is not surprising that prior to the WTO, free traders (e.g., Low 1993⁹) argued that not only were GATT disciplines defined too weakly, they were also enforced too laxly.

The Uruguay Round made major changes to the rules on trade in goods. It swept the TBT agreement along with the GATT itself under the umbrella of the WTO and introduced tougher dispute settlement understanding. The combination of new restraints on standards and technical barriers and binding dispute settlement makes the parallels (and intersections) between multilateral and EU approaches to trade in goods particularly intriguing.

In a nutshell the Uruguay Round agreement on technical standards is based on the Tokyo Round code. Both stress the procedural elements of standard setting, emphasise non-discrimination, and insist that *unnecessary* obstacles to trade must not be created. The 1994 code (Article 2) goes a bit further in saying that international standards shall be used where they exist, unless they are not adequate to pursue legitimate ends. It adds that any more stringent departure from international norms must include scientific evidence 'among the relevant considerations.' The 1994 code (Article 2.7) also says that member states shall 'give positive consideration' to mutual recognition of others' norms that achieve the same effect.

Increasingly, however, the WTO dispute settlement procedure is making reference to Article XX of the original GATT, which provides for a series of health and environmental exceptions to the general free trade obligations. In September 2000, for example, a panel decided that a French ban on the sale of asbestos products was a violation of the non-discrimination requirements (as it treated asbestos differently from "like" materials), but that in the light of the scientific evidence presented this ban was nevertheless justified under

⁹ Low (1993: 5) is not untypical in writing, "Seriously buffeted by multiple challenges to its authority and integrity the [GATT] system has proven less and less capable of mediating trade relations among countries."

GATT Article XX.¹⁰ The panel tried to avoid pronouncing on the scientific facts, but concluded that there was enough scientific evidence for a reasonable decision-maker to have acted as the French government had.¹¹

Jackson (1997) notes that there is ambiguity about the burden of proof regarding the scientific basis of contested measures. However, he notes, there is far less ambiguity in the separate code governing sanitary and phytosanitary (SPS) measures. This is the subclass of technical regulations governing food and animal health.¹² Hoekman and Kostecki (1995) note that the United States was particularly dissatisfied with the weakness of the TBT code as a means of addressing EU bans on certain US agricultural products and hence pressed for tighter SPS measures.

The SPS agreement is remarkable in that it seems to go well beyond the TBT agreement in many respects. It lays down a tighter regime of scientific testing (Articles 3 and 5), and states that members 'shall accept' others' standards even if different so long as the exporter can 'objectively' demonstrate equivalence of effect (Article 4). It also goes much further than the TBT agreement in requiring member states to base their rules on international standards, specifically the *Codex Alimentarius*. Jackson (1997) reports US satisfaction at the much more specific rules in the SPS agreement than the TBT agreement regarding the way scientific evidence had to be used to justify measures stricter than those agreed in the *Codex*.

The wording appears to place the burden of proof firmly on member governments that wish to adopt higher standards. The combination of new WTO rules and a modification of the

¹⁰ European Communities –Measures affecting asbestos and asbestos – containing products, WT/DS135/R 18 September 2000.

¹¹ In an intriguing passage which we do not have space to analyse here, the panel noted that “to make the adoption of health measures concerning a definite risk depend upon establishing with certainty a risk already assessed as being lower than that created by chrysotile would have the effect of preventing any possibility of legislating in the field of public health. In fact, it would mean waiting until scientific certainty, which is often difficult to achieve, had been established over the whole of a particular field before public health measures could be implemented,” para 8.221.

¹² For reference, about 70 of the 300 proposals contained in the Commission's 1985 White Paper on Completing the Internal Market concerned sanitary and phytosanitary measures.

Codex rules on beef hormones enabled the US to challenge successfully the EU ban on hormone-treated beef, which was previously, apparently, GATT-compatible. Invoking new rights under the SPS agreement, the US, supported by Canada, challenged the EU's ban on hormone-treated beef, arguing that there was little or no scientific evidence that the specific substances in question posed an actual risk and that the onus of proof lay with the EU. The EU relied on the fact that there was some indirect evidence that the class of hormone in question was carcinogenic. The EU submission made it clear that the EU had introduced the measures largely to allay public fears. Curiously, although the EU referred to the precautionary principle, it did not formally invoke Article 5.7 of the SPS agreement, which covers 'cases where relevant scientific evidence is insufficient.'

The WTO's Dispute Settlement Panel (August 1997) and the Appellate Body (January 1998) both found against the EU, although Appellate Body rejected two of the Panel's three findings, insisting that governments have the right to depart from *Codex* standards if they can show some scientific evidence that their more restrictive regulations enhance consumer safety. As a result, the issue turned on whether the EU's prohibition was based on a satisfactory risk assessment. Neither WTO tribunal carried out tests of its own, but gave more credence to the experts called by the US who said that evidence used by the EU could not justify the measures applied. A detailed procedural requirement was thus turned into a substantive finding by the WTO.

Under the terms of the beef-hormone decision, however, the government has the right to exclude a product if it can show that its own standards provide a greater degree of safety than the *Codex* norms. Thus, while there is an obligation to show that you have some scientific evidence that excluded products might pose a risk greater than that presented by products produced to domestic standards, there is no obligation to prove that the additional risk is very high.

Some have argued (e.g. Scott **2000**) that even though the beef-hormone decisions are not as draconian as some initially depicted them, they actually intrude slightly more profoundly on national sovereignty than the ECJ's rulings in the rare cases where countries have tried to invoke Article 30 (ex-36) on health and safety grounds. Such national controls are usually considered consistent with the single market provided that they are applied the point of sale not at the border.

The SPS Agreement is of course a very special case, but if the beef-hormone judgement had gone the other way this would have indicated that the new WTO regime did not make any difference. The beef-hormone judgement was to some extent balanced by the shrimp-turtle decision that upheld the US ban on imports of shrimp from countries that do not demonstrate that their trawlers match US efforts to protect sea turtles. In other words, environmental considerations can over-ride trade rules in some cases. Seen in this light, the implication of the beef-hormone case is that, as in the EU, regulations that impede trade must be objectively justified and are subject to challenge and 'judicial' review.

Services

The General Agreement on Trade in Services (GATS), which was concluded as part of the Uruguay Round, is the first multilateral and legally enforceable agreement governing trade and investment in services. With the limited exceptions of the agreements in basic telecommunications and financial services, the GATS did not significantly advance liberalisation in services, rather it codified the existing state of domestic liberalisation. It did, however, establish a foundation for future liberalisation (Hoekman and Kostecki 1995).

The GATS establishes a general framework containing general concepts, principles — most importantly MFN— and rules that apply to all measures affecting trade in services, which apply to all sectors unless explicitly excluded (a 'negative list' approach). The meat of

the agreement, however, is made up of specific national commitments on national treatment and market access. These commitments are made on the basis of a 'positive list' approach — they apply only to those sectors and modes of supply (movement of customer, cross-border, establishment, and temporary residence) explicitly identified by each government. Potentially significantly, the GATS provides scope for members to go beyond national treatment through agreed mutual recognition on a bi- or plurilateral basis without infringing MFN.

The combination of binding existing levels of regulation, a positive list approach and the EU's generally liberal service regime means that the GATS imposes a relatively light burden on the EU. This is supported by the almost complete absence of dispute settlement cases concerning GATS (WTO, 2000). A rare exception is the licensing provisions of the EU's banana trade regime.

Consequently, it is the more procedural requirements that are likely to have greater, though hardly onerous, implications for the promulgation of European services regulations. These principles include requiring that relevant policies be published in a timely fashion and that domestic regulation be based on objective and transparent criteria and not be more burdensome than necessary.

The agreements on basic telecommunications and financial services were concluded after the end of the Uruguay Round and went further towards liberalisation. The basic telecommunications agreement differs from the general GATS Agreement in that a number of countries, including some EU member states, accelerated their liberalisation plans, and almost all countries signed up to regulatory principles designed to ensure access to infrastructures and to constrain anti-competitive behaviour by market incumbents. In this respect the telecommunications agreement bore some of the hallmarks of the EU regime, which anticipated it (just), in leaving the basic regulatory responsibilities with the member states, but subjecting these to an external regime in which competition principles are central

(Holmes, Kempton and McGowan 1996). The telecommunications regime goes further into detail in this respect than do other parts of the GATS. This raises the prospect that the WTO members will be put under pressure to ensure that their competition policy definitions and practices are compatible with any emerging GATS jurisprudence. The financial services protocol follows the general framework of the GATS and concentrates only on access for and treatment of service providers. Consequently, it does not impinge upon governments' conduct of macroeconomic policy or on prudential regulations, unless they are used as a means of avoiding commitments or obligations under the agreement. Governments may also retain non-prudential regulations, such as requirements to lend to certain sectors or to offer preferential rates to certain people, so long as they are not discriminatory, are not intended to restrict access to the market, and do not constitute unnecessary barriers to trade. Members may also introduce temporary restrictions in the event of serious balance-of-payments and external financial difficulties, subject to consultations with WTO members.

Investment

The GATS is also the only binding multilateral framework that directly addresses investment, but only with respect to services (Brewer and S. Young 1998). The GATS agreement applies the general principles of MFN and national treatment principles to establishment. As noted above, however, national treatment applies only to those sectors that a government explicitly says it does. Meanwhile the WTO agreement on trade-related investment measures (TRIMs) actually dealt more with investment-related trade measures (but IRTMs would have been hard to pronounce); that is to say it controlled such matters as import and export regimes affecting investors not the rules governing establishment, so it did not impinge on sensitive domestic regulatory matters. As a consequence, the multilateral regime does not impose strict disciplines on EU (or other) member governments' foreign investment policies.

By contrast the unsuccessful negotiation of a Multilateral Agreement on Investment (MAI) within the Organisation for Economic Cooperation and Development (OECD) would have constituted a far more intrusive framework. Significantly for our purposes, the autonomy of national regulators, particularly with respect to the environment, was one of the crucial issues that contributed to the collapse of the talks (Young, 2000). There was concern, particularly in environment ministries and among non-governmental organisations, that multinational corporations might be able to use the MAI's binding investor-state dispute settlement provisions to challenge national rules that were discriminatory in *effect* as well as those that were discriminatory in law.¹³

A multilateral framework for investment is still under discussion (see, for example, Council, 1999b), but it will almost certainly be much less intrusive on national regulatory sovereignty.

Competition

The only existing multilateral rules on competition are those contained in the reference paper on 'basic' telecommunications services trade, mentioned above. There is, however, some support, particularly within the EU for extending this type of provision to other aspects of the multilateral regime (Council, 1999b).

The debate on international competition policy has, paradoxically, benefited from the Seattle breakdown. The discussions in the WTO working group established under the Singapore mandate were making slow but real progress in identifying areas where some form of international action or agreement is appropriate. It was agreed in early 2000 to extend the Working Group's existence to build on a number of ideas that were emerging. Probably the most important advance has been that the debate has managed to move on from the

¹³ GATT had always covered both "facial" and "non facial" discrimination. But the introduction of binding

mercantilist focus of the EU's attempts to attack private barriers to market entry for its exports to a discussion of how the international system can best assist the developing world create appropriate competition policies.¹⁴ The EU's commitment to this issue has led to some real results, but the outcome will probably not be a global replication of the Europe Agreements, even though the EU is extending this into its own wider bilateral arrangements, such as the post-Lomé provisions.

Intellectual Property Rights and the WTO

As we saw above the EU's member governments have had such different views on intellectual property rules that they have not agreed a common regime. An argument can be made that the EU's own experience shows that differences in intellectual property regimes are not a particularly big issue for market integration, although the Commission would beg to differ. Intellectual property rights did not figure in the 1985 Cockfield White Paper on completing the single market¹⁵ and was not an issue in the Cecchini studies¹⁶ on the economic impact of the single market. ECJ jurisprudence in fact suggests that problems did not arise due to differences in national intellectual property rules, but from *similar* rules that allowed market segmentation. What did matter was to ensure that holders of an intellectual property rights in one territory could not use this to exclude other legitimate sellers.

At the time of the Uruguay Round developing countries argued that the same principle used inside the EU of "regional exhaustion" should be generalised so that traders could buy intellectually-property protected products in the cheapest market in the world and move them

dispute settlement dramatically widens the impact of a "non-discrimination" requirement, so that it covers everything which a tribunal might consider discriminatory

¹⁴ At an OECD conference in Paris, July 1999, the South African delegate made an apparently ironic comment that developing countries needed technical assistance before rather than after any international competition policy negotiations so they knew what they might be letting themselves in for. This has been turned into a genuine proposal for a technical assistance programme in competition policy, enthusiastically backed by Britain's DFID.

¹⁵ 'Completing the Internal Market: White Paper from the Commission to the European Council (Milan, 28-29 June 1985), COM (85) 310 final.

freely. The EU and US, apparently at the behest of powerful owners of intellectual property rights, however, pressed for all countries in the world adopt roughly US style patent laws (Maskus,2000). Most developing countries were reluctant, but sensing a *quid pro quo* for greater access to the US market, acquiesced on intellectual property rights. Thus the WTO, curiously, took its first step in positive integration in an area that the EU had left to last.

EU-specific implications

While the broadening and deepening of the multilateral framework described above has implications for the regulatory sovereignty of all WTO member states, there is reason to think that this dual shift poses some particular problems for the EU.

First, both the banana and beef-hormone disputes with the US raise the question of whether the EU is sufficiently 'joined-up' to be able to handle complex negotiations across a wide range of issues. Superficially, at least it appears as though the European negotiators in the GATS negotiations, for example, were unaware of the specifics of the licensing requirements of the EU's banana trade regime. There also appears to have been a lack of communication between the EU participants in the SPS negotiations and the European representatives to the *Codex Alimentarius*.

Managing complexity across a broad range of issues is by no means an EU-only problem. However, the awkward allocation of authority within the EU, with the EU being responsible for some matters and member governments for others may make the challenge particularly difficult. Further, it would appear that the consultative mechanisms between particularly the European Commission and European business and civic interests groups, at least with respect to trade issues, is rather poor, at least compared to the situation in the US (Young, 2000). Although there may well be advantages to this, it does mean that European

¹⁶ See the summary in Emerson et al. 1998.

negotiators have less information about the potential impact of proposed measures on European firms and citizens. Lastly, contrary to the picture depicted by British Euro-sceptics, the Commission is actually a very small bureaucracy, which makes covering a broad and complicated negotiation difficult.

Second, and particularly important for our purposes, is that the WTO system, particularly the SPS Agreement, appears to give less weight to the 'precautionary principle,' which states that governments should intervene even when a danger is not fully understood, than the EU system. This perception stems largely from the WTO's judgement in the beef-hormone case and may be overstated as, as noted earlier, the EU's measures were based on a very weak assessment of the risks involved. Nonetheless, if the Appellate Body's ruling that there must be a 'rational relationship' between a risk-assessment process and the measure under consideration is a substantive requirement rather than just a procedural one, it could leave little room for precautionary measures (Ward, 1999).

Significantly, the Cartagena Protocol to the UN's Biodiversity Convention on trade in genetically modified organisms incorporates a stronger and more specific statement of the 'precautionary principle,' largely at the insistence of the EU and developing countries (Cosbey and Burgiel, 2000). The status of the agreement in relation to the WTO was left ambiguous, however, because of strong differences between the US, which wanted it to be subordinate to the WTO, and the EU, which did not.

Third, there is at least a theoretical potential for the multilateral trading system to impose greater restrictions on the member governments than the EU itself. In the light of the greater emphasis on the precautionary principle in EU law, it is possible to conceive of a regulation adopted by an EU member government that complies with the EU treaties (particularly in the light of Articles 30 (ex 36) and 95 (ex 100a4), but that falls foul of multilateral rules (specifically the SPS agreement), (see Scott, 2000)

Fourth, implementing WTO dispute settlement findings may be particularly difficult for the EU. In both the hormone-treated beef and banana trade regime cases, the EU has been unable to adopt new rules that are WTO consistent. Difficulties in adopting new rules in order to comply with international commitments are hardly restricted to the EU; Australia (twice), Brazil, Canada and the US have also had their implementation of dispute-settlement findings challenged (WTO, 2000). Nonetheless, it is possible that the EU's character as an international organisation in which common rules are hard-won compromises means that there is less scope in which to find other mutually acceptable outcomes.

The Compounding Effects of Eastward Enlargement

Enlargement will have three distinct regulatory implications for the EU's external economic relations. The first is at least superficially familiar. Previous enlargements, particularly that of Spain, have provoked claims from the US (under Article XXIV of the GATT) that new members' levels of trade protection have increased as a consequence of accession. The new round(s) of enlargement will pose the same issues, especially with respect to agriculture, and potentially more difficult ones with respect to services and regulatory barriers. As discussed earlier, protectionism in these latter areas is notoriously difficult to quantify and thus may be a source of serious dispute. At the very least, the broadening of the multilateral agenda (and accompanying national commitments) increases the range of sectors and issues in which trading partners may request compensation.

A second and potentially more profound challenge may arise because, by increasing the diversity of membership, enlargement will complicate the already delicate regulatory balance within the EU. We have argued that the current state of play within the EU highlights the difficulties of proceeding with minimum standards and mutual recognition, particularly with respect to trade in goods. Combined with the limits being encountered within the existing membership of the EU, we are inclined to speculate that as enlargement approaches

the EU may find itself under pressure to rethink its approach. There could be pressure either to strengthen common standards, which would impose even tougher disciplines on the candidate countries, or to make greater use of non-discrimination rather than mutual recognition. As mutual recognition and minimum standards pose relatively low compliance costs on third-country (as well as EU) firms (Commission, 1997b), any shift towards a greater reliance on detailed common regulation will likely generate more technical barriers to trade and engender new trade disputes.

The third challenge stems from clashes between the applicant countries' multilateral and European commitments, particularly in the run-up to enlargement. Despite efforts at coordination during the Uruguay Round, there are some areas in which the multilateral obligations of the applicant countries and the imperatives of the accession process are in conflict. This has led to disputes between the applicants and third countries on the one hand and the EU on the other. In particular, the EU contends that applicants that put international obligations and specific trading arrangements above the provisions of the Europe Agreements and their future obligations as member states are acting contrary to the spirit of accession.¹⁷

In certain cases candidate countries have implemented more liberal trade regimes than the EU for certain products, particularly agriculture, and where these are bound, the candidate faces a conflict with its WTO commitments and its accession obligations. The applicants may even get dragged into disputes not of their own choosing. The EU, for example, has put pressure of Poland to take its side in a dispute with Canada over patent protection for

¹⁷ Agenda 2000 (Commission, 1997a) states:

The applicant countries must abide by commitments they have made in the framework of the WTO and the OECD. But there have been a number of disputes between the Union and certain applicant countries, in cases where the latter have put international rules, such as the most favoured nation clause or certain trade arrangements, above the provisions of the Europe Agreements and their future obligations as member states. Such an approach is contrary to the spirit of gradual adoption of the *acquis communautaire*. [need page number]

pharmaceuticals, even though WTO obligations were ambiguous and arguably, that Poland's interests in this case coincided with Canada's.

Conclusions

This paper suggests four main conclusions. First, even though the EU is a relatively small and homogeneous club of countries, it is beginning to reach the limits of mutual recognition. This strongly suggests that there are real (and proximate) limits to the applicability of mutual recognition, at least without an accompanying degree of agreed approximation, to the multilateral trading system. This implies that the EU, particularly the European Commission, should consider carefully in which areas and under what conditions might the EU serve as a useful model for multilateral rules. Second, enlargement will make the EU a larger and even less homogeneous club, which implies that mutual recognition will become even more contested within the EU. How the EU will respond to this challenge is as yet unclear. The most politically difficult, but most integrationist approach would be to pursue more and closer approximation. This is a much more interventionist approach than mutual recognition and consequently has more profound implications for products from third countries and is more likely to fall foul of multilateral disciplines.

Third, the extension of EU rules to the countries of central and eastern Europe through the pre-accession process and enlargement is a further potential source of tension with the EU's trading partners. This is fundamentally a consequence of the breakdown of the distinction between regional integration as 'deep integration' and multilateral liberalisation as 'shallow integration.'

Fourth, the EU will face the challenge of either trying to reform WTO rules and procedures to secure a better balance between market opening and legitimate protection (e.g., increase role of 'precautionary principle') or else having to undertake internal adaptation

(e.g., on role of scientific evidence in rule making, judicial enforcement and the scope for derogations). The multilateral system thus risks compounding the EU's legitimacy shortcomings both among the current members and in the wider Europe.

Table 3. The EU framework of regulation

	Treaty principle	Treaty qualification	Secondary legislation
Goods	Quantitative restrictions on imports and all measures having equivalent effect shall, without prejudice to the following provisions, be prohibited between member states. (Art. 30 (28))	... Articles 30 to 34 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between member states. (Art. 36 (30))	mutual recognition new approach directives detailed harmonisation centralised authorisation
Services	... restrictions on freedom to provide services within the Community shall be progressively abolished during the transitional period in respect of nationals of member states who are established in a state of the Community other than that of the person for whom the services are intended (Art. 59 (49))		<u>transport</u> : abolition of quantitative controls + common qualitative measures (incl. safety). <u>financial services</u> : approximation of prudential supervision + home country control <u>telecommunications</u> : rules to ensure market access
Investment	... restrictions on the freedom of establishment of nationals of a member state in the territory of another member state shall be abolished by progressive stages in the course of the transition period (Art. 52 (43))	The provisions of this chapter and measures taken in pursuance thereof shall not prejudice the applicability of provisions ... providing for special treatment for foreign nationals on grounds of public policy, public security of public health (Art. 56 (46))	liberalisation of capital movements and abolition of exchange controls. service-sector-specific rules works-council directive merger control directive

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