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## **Toward An Industrial National Policy: Does The European Community Provide A Useful Guide?**

*Hans Smit\**

### I. INTRODUCTION

**T**he Rome Treaty that created the European Economic Community in 1958 pursues two major goals: The first is to create a customs union eliminating all duties and equivalent charges at the common borders of the member states and imposing a common external tariff; the second, and potentially more important, is to provide the premises on which a truly economically, and ultimately politically, integrated single market is to be developed.<sup>1</sup>

The United States is, for most practical purposes, a customs union, so that little practical guidance can be drawn from the European experience as far as this aspect is concerned. I will, therefore, concentrate on a comparison of the European Communities' premises for, and implementation towards, a truly integrated single market with those present in the United States. Narrow technical analyses will be avoided; general themes will be painted with a broad brush.

This comparison will show that, in many important respects, the European Community has gone far beyond the United States in creating a truly integrated market and that, consequently, the Community does provide a useful guide to the United States.

Study of the European developments also prompts another significant question. That question is how the United States will achieve a truly integrated market with Canada and Mexico without addressing, and providing solutions for, the types of problems that the Community has resolved or set out to resolve, but the United States has not even addressed within its own borders. As will be demonstrated, the United States has a long way to go.

### II. THE COMMUNITY'S SCHEME

#### *A. No Discrimination on the Basis of Nationality*

The prohibition of discrimination on the basis of nationality is what the ECC Treaty itself calls one of the foundations of the Commu-

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<sup>1</sup> See HANS SMIT & PETER HERZOG, 1 THE LAW OF THE EUROPEAN ECONOMIC COMMUNITY: A COMMENTARY ON THE ECC TREATY, 24-25, 1-24 *et seq.* (1976).

nity.<sup>2</sup> It is likely to play a prominent role in the efforts of the EC Court of Justice to break down the pattern of nationalistic legislation. Thus, the Court of Justice has already ruled that nationality is an improper requirement for admission to the Bar.<sup>3</sup> It will be interesting to see to what extent the Court will eliminate nationality as a requirement for appointment to other positions with public authority aspects.

### B. *No Barriers at the Borders*

The Rome Treaty outlaws not only tariffs at the borders of the member sales on internal trade, it also prohibits all measures having an equivalent effect.<sup>4</sup> This created a problem under the old cascade system of turnover taxes (under which a turnover tax at the full rate was levied at each stage the product changed hands), when states imposed compensating levies on imports. Since, under the cascade system, it was impossible to determine exactly what portion of the price of a good represented turnover taxes (this depended on the number of times the product had been sold in the manufacturing and distribution chain), states, in order to promote exports, tended to estimate the turnover tax portions to be high, and thus to give a hidden export subsidy, when the turnover tax was imposed upon import. The Community, therefore, required all member states to switch to an added value tax, which made it possible to determine with precision the tax portion of the price upon the product's crossing a border.<sup>5</sup>

Many hidden barriers to the free movement of goods remain. An important example is a governmental purchase policy favoring domestic purchases. Others are technical requirements and differences that impede free movement of goods. I was recently confronted by one of these when I took my portable telephone from Holland to France and found that French Telecom used a different plug and was unable or unwilling to provide a converter. The Community is intent upon eliminating those differences and thus to insure that goods can travel to the markets with the best opportunities.

### C. *Free Movement of Labor, Services, and Capital*

To insure that all market forces can operate freely across national borders, the Rome Treaty provides not only for the free movement of goods, but also for that of labor, services, and capital. Of course, im-

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<sup>2</sup> TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY [EEC TREATY] art. 7; SMIT & HERZOG, *supra* note 1 at 1-48, 1-51.

<sup>3</sup> Claude Gullung v. Conseil de L'ordre des avocats du Barreau de Colmar et Anor, Case 292/86, 1989 E.C.J. 526 (1988). See also Council Directive 77/249, 1977 O.J. (L78) 17 (facilitating the effective exercise by lawyers of freedom to provide services.).

<sup>4</sup> EEC TREATY, arts. 3(a), 9(1), 12, 13; SMIT & HERZOG, *supra* note 1 at 2-43.

<sup>5</sup> EEC TREATY, arts. 97, 98, 99; SMIT & HERZOG, *supra* note 1, at 3-429, 3-447, 3-460.

portant impediments to such movements, such as differences in language, laws, and banking and other commercial practices, continue to exist. For example, differences in social legislation relating to such subjects as health insurance, workmen's compensation, and other welfare payments significantly affect the movement of workers. Therefore, the Treaty does provide the legal means for overcoming these. And significant progress in all of these areas is being made. The common currency envisaged by the Maastricht Treaty<sup>6</sup> will move the developments in this direction another important step forward.

#### *D. No State Subsidies*

States frequently seek to induce investors to make investments within their borders by offering various forms of facilities, including subsidies. The Rome Treaty outlaws these practices as incompatible with the elimination of national borders for economic purposes. The Commission, the Community's principal executive organ, has been very active in combatting these types of practices.<sup>7</sup>

#### *E. Common Rules on Direct and Indirect Taxes*

Since a great many laws influence the movement of economic forces, the Treaty provides for their harmonization. It now gives the Council authority to legislate in this area measures binding directly in the Community. Initially, it authorized it only to issue binding directives to the member states to harmonize their laws in the manner indicated in the directives.<sup>8</sup> The most important activity in this area has concerned the indirect or turnover taxes. These account for very sizeable parts of the national budgets of member states. They are liked by legislatures, because they are often hidden (the purchase price of a product includes the tax), they are assessed on all transactions, regardless of whether they produce a profit or loss, and they are relatively easy to collect. Of course, they weigh disproportionately heavily on those who must spend all their income on purchases for their daily life and lack any progressivity. Since they are collected at the same rate from the poor and rich alike, in an ideal world, they should be abolished at once. But in the Community, this would require a substantial increase in other taxes and is therefore politically impossible. As already mentioned, the Community decided to require the member states to adopt an added-value tax system and has forbidden use of a cascade system.<sup>9</sup> Thus, although the rates of the added-value tax still differ in

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<sup>6</sup> EEC TREATY (Maastricht Version) 105A (1992).

<sup>7</sup> EEC TREATY, art. 92, *see also* Council Directive art. 28, 1964 O.J. 195 N.W.; SMIT & HERZOG, *supra* note 1, at 325.

<sup>8</sup> EEC TREATY, art. 99; SMIT & HERZOG, *supra* note 1, at 3-456.

<sup>9</sup> *See generally* EEC TREATY.

the member states, significant harmonization has been achieved. But, of course, since the rates continue to differ, the burden of these levies continues to vary from state to state. The next step will be to harmonize added-value tax rates and income and corporate taxation which also impact on competitive conditions. This will be a much more complex task.

#### F. Competition Policies

Once the Treaty makers had provided for the foundations of the Community, they addressed the question as to how it was to be governed. The Treaty makers opted for the solution that motivates the American system: On the internal market, competition is to be the prime regulator. It made sense to place primary reliance on competition, since it would have been politically difficult to agree upon the authorities that would have to provide regulation if the model of a regulated economy had been chosen.

As might be expected, the American antitrust laws provided principal legislative inspiration. However, the Treaty makers adopted one basic difference. The primary rules, embodied in Article 85 and 86 of the Treaty, are that agreements in restraint of competition or abuse of a dominant position in interstate commerce are prohibited, but the Commission has been given the authority to exempt agreements that would otherwise come under the ban of Article 85 if they produce socially desirable effects. Similarly, since only abuse of a dominant position is prohibited, a mere dominant position is not condemned; only its economically reprehensible use is.<sup>10</sup>

In the implementation of the antitrust rules, the Community has also consistently made a distinction between large and medium-size and small enterprises.<sup>11</sup> General rulings by the Commission pursuant to authority bestowed by the Council have also brought needed clarification in regard to application of the Community's antitrust rules to common types of agreements, such as those relating to distributorships, patent licensing, franchises, mergers, specialization, market rationalization, and similar subjects.<sup>12</sup>

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<sup>10</sup> EEC TREATY, art. 86; SMIT & HERZOG, *supra* note 1, at 3-251.

<sup>11</sup> The EC Commission has issued a Notice, dated May 27, 1970, Relating to Agreements, Decisions and Conscripted Practices of Minor Importance, 68 O.J. (C75) 3, 1968 O.J. (84) August 28, 1968, in which it states its view that Article 85 (1) does not cover arguments between commercial enterprises the annual sales of which do exceed twenty (20) million units of account. Under Commission Regulation 417/85, relating to specialization agreements, 1982 O.J. (L376) 3, art. 3(1), specialization agreements are exempted if the enterprises involved do not represent more than twenty (20%) percent of the relevant market and their annual sales do not exceed 500 million units of account. See generally PUGH & SMIT, INTERNATIONAL BUSINESS TRANSACTIONS IN THE COMMON MARKET, Installment III, 24-86 (mimco. 1993).

<sup>12</sup> See generally PUGH & SMIT, *op. cit. supra* note 11.

### G. Other Policies

1. *Harmonization.* The Treaty also provides for harmonization of laws, other than those dealing with taxes, that may impact on the development of a single market. Since the Treaty does not provide adequate authority for the Council to legislate in all relevant areas, certain subjects, on which uniformity was deemed desirable, have been regulated by separate treaty. One of these is that relating to the recognition of foreign judgments on which the Treaties of Brussels and Lugano were concluded.<sup>13</sup> A similar treaty has been prepared on a Community-wide patent<sup>14</sup> and work continues towards creating a European type of corporation.<sup>15</sup>

In other areas, harmonization has gone forward apace, aided by a growing inclination on the part of the Council to become quite specific in the directives it issues to the member states. This has led member states simply to adopt in the form of a statute the contents of the applicable directive. In some cases, the Court of Justice has even ruled that a directive susceptible of immediate application is binding law in the member states, thus achieving what the Treaty makers are unlikely to have contemplated.<sup>16</sup>

Since the application of different rules of choice of law may lead to application by courts of member states of different rules of law to the same event or occurrence, efforts have also been made to make uniform choice of law rules.<sup>17</sup> Efforts to achieve further uniformity continue, including in such areas as product liability and corporate law.<sup>18</sup>

2. *Common economic policies.* In this area, significant progress has been made in the Community's acting as the party representing the member states in international trade negotiations, principally those relating to the GATT. Recently, the arrangement under which the member states agreed jointly to maintain foreign exchange fluctuations within narrow bands suffered a setback when Great Britain stepped out of the arrangement and France was forced considerably to widen its band. Pursuant to special Treaty provisions, the Community has also

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<sup>13</sup> Convention of Brussels on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters, 1978 O.J. (L304177); Convention of Lugano on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, 1988 O.J. (L319).

<sup>14</sup> Convention on the Grant of European Patents, 13 ILM 270 (1973).

<sup>15</sup> European Companies Statute, 1970 O.J. 124.

<sup>16</sup> Case 43/75, *Defrenne v. Sabena*, 1976 E.C.R. 455.

<sup>17</sup> These efforts have resulted in the formulation of the EC Convention on the Law Applicable to Contractual Obligations of June 19, 1980, 1980 O.J. (L266) 1 and a Draft Convention Relating to the United Recognition of Companies and Legal Persons of February 29, 68 (CCH (C.M.R.)) 6311.

<sup>18</sup> Council Directive of July 28, 1985, on the Application of the Laws, Regulations and Administrative Provisions of the Member States Concerning Liability for Defective Products, 1985 O.J. 1210, 29.

adopted and implemented a common agricultural policy under which Community-wide price supports are paid to Community farmers and common external levies are imposed on foreign imports. Although it was contemplated that the supports and levies would be gradually reduced to bring farm product prices to a level competitive with those in the rest of the world, this has proven to be particularly difficult. As a result, the Community has accumulated large surpluses (the butter mountain).<sup>19</sup>

In the other areas addressed by specific Treaty provisions, including business cycles, balance of payments and social policy, numerous measures have been taken aimed at integrating national policies. Thus far, however, the member states have been less than enthusiastic about transferring their authorities in these areas to Community institutions. Indeed, the Maastricht Treaty specifically declares the Community's adherence to the principal of subsidiarity, under which the Community will not exercise its authority when the problems to be addressed can adequately be dealt with by the member states.<sup>20</sup>

#### H. Institutional Support

The Treaty has created several institutions designed to provide financial support for efforts to implement Community economic policies. By and large, these institutions have performed rather well.

The European Investment Bank's task is to provide financing to less developed regions. It has been both a social and financial success. Large amounts have been raised on capital markets to provide loans for the development of economically disadvantaged regions which have provided significant returns, both for the regions involved and for the Bank.<sup>21</sup>

The European Social Fund to which the member states contribute in prescribed ratios provides financial support when the process of economic integration causes social disruptions. It finances programs of re-training for dislocated labor.<sup>22</sup>

### III. THE AMERICAN EXPERIENCE: THE PAST, THE PRESENT, AND THE FUTURE

#### A. The Unitary Market

##### 1. Sales taxes. In the United States, goods, persons, services, and

<sup>19</sup> On the EC Agricultural Policy, *see generally*, PUGH & SMIT, INTERNATIONAL BUSINESS TRANSACTIONS IN THE COMMON MARKET, INSTALLMENT I, at 21-24 (mimeo. 1993).

<sup>20</sup> EEC TREATY, (Maastricht Version) (1992).

<sup>21</sup> EEC TREATY (Maastricht Version) (1992). On the European Investment Bank, *see* EEC Treaty, art. 129; SMIT & HERZOG, *supra* note 1.

<sup>22</sup> On the European Social Fund, *see* EEC Treaty, art. 123; SMIT & HERZOG, *supra* note 1.

capital move freely across state lines. However, it is rather amazing that impediments to cross-border movements continue to exist that have been eliminated in the European Community. No efforts have been made to address the impact of the proliferation of turnover taxes, generally of the cascade type, on cross-border movement of market factors. The failure of any action in this regard is the more surprising, since the differences in turnover taxes have given rise to public recriminations. In New Jersey, Ikea, a Swedish concern, aggressively advertises in New York that purchases at its New Jersey establishment are taxed at a significantly lower rate than that prevailing in New York. It has organized a special bus shuttle service from New York for its customers from New York. New York has retaliated by posting its tax inspectors in the Ikea parking lot who record the numbers of New York license plates on cars in the lot and notify the owners of the cars that they owe New York's compensating levies on their New Jersey purchases.

It would appear obvious that, in a truly integrated market, these conditions cannot be countenanced. The easiest solution would be for the Supreme Court to declare the imposition of compensating levies to be a constitutionally impermissible burden on interstate commerce. However, the Supreme Court, thus far, has not so ruled.<sup>23</sup> Another solution would be to adopt a federal statute outlawing such levies, which could, of course, be squarely based on the interstate commerce clause. It is uncertain, however, whether such a statute is politically achievable. A less drastic solution would be that indicated by the European Community's experience: A statute setting uniform standards for local sales taxes and establishing a proper regime for refunds and compensating levies.

2. *Income and corporate taxes.* The different state income and corporate taxes inescapably affect the movement of production factors across state borders. Efforts to limit this impact by reliance on constitutional provisions have not met with judicial approval. Thus far, the Supreme Court has not had occasion to rule on the constitutional merits of the so-called unitary tax adopted by some states in order to maximize their tax revenues. A unitary tax taxes the local revenues of an out-of-state corporation at a rate computed on the basis of the worldwide revenues of all of its affiliated companies.<sup>24</sup> The consequence of this treatment is to impose a substantially higher tax on the local revenues of a domestic corporation than are imposed on the local revenues of a domestic corporation that has no out-of-state affiliates. To the extent the unitary tax discourages out-of-state corporations from seeking

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<sup>23</sup> *Commonwealth Edison Company v. Montana*, 453 U.S. 609 (1981). See also, *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274 (1977).

<sup>24</sup> *Franchise Tax Board of California v. Alcan Aluminum Limited*, 493 U.S. 331 (1990).



to generate revenues through a subsidiary within the state, it would appear to interfere with the free flow of market forces. It would therefore appear desirable for Congress to address this practice if the courts did not rule this type of tax an impermissible burden on interstate or foreign commerce.

3. *Local subsidies.* The practice of states of the United States, through subsidies, tax breaks, and other similar incentives, to seek to attract foreign business and to persuade local business not to depart is increasingly recognized as undesirable.<sup>25</sup> As already explained, it is illegal in the Community.<sup>26</sup> In the United States, its legal status has thus far received little attention. Indeed, while the practice has been widely criticized, its legality has not been seriously questioned. Any legal attack on the practice faces significant obstacles. First of all, it is unclear who has standing to attack the practice. A taxpayer would have no standing under *Frothingham v. Mellon*,<sup>27</sup> for he could not establish that his tax burden would decrease or that he would receive any other benefit if the subsidy were discontinued. However, standing could, under the *Scrap*<sup>28</sup> case, be based on the injury in fact that a competitor could show it suffered as the result of having been put in a competitively disadvantageous position. A competitor could easily demonstrate that it no longer played on a level playing field with a competitor who had the benefit of public subsidies that it did not receive.

Consideration should also be given to the question of whether a state could sue another state for improperly extending these subsidies. In the European Communities, a member state can bring an action against any other member state or violation of the Rome Treaty. In the United States, a state can bring an action against another state in the U.S. Supreme Court for violation of the rights states have under the Constitution. It may be questioned, however, whether a state has standing to assert a claim on behalf of its subjects.

Assuming that there is a litigant with standing to complain, the next question is what claim for relief can be asserted. The Constitution, unlike the Rome Treaty, does not address this issue specifically. The claim would therefore have to be drawn from the Constitution by creative construction. One possible construction would be that the granting of subsidies of this kind artificially distorts, and therefore improperly burdens, interstate and foreign commerce. It could further be argued that programs for luring out-of-state investors into the state impermissibly invade an area preempted for federal regulation under the interstate and foreign commerce clauses. It should be noted that only states could advance these claims, since, under *Frothingham*, a private liti-

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<sup>25</sup> E.J. Dionne Jr., *The Jobs-For-Cash Scandal*, WASH. POST, Aug. 24, 1993, at A17.

<sup>26</sup> See *supra* note 7.

<sup>27</sup> *Frothingham v. Mellon*, 262 U.S. 447 (1923).

<sup>28</sup> *U.S. v. Students Challenging Regulatory Agency Procedures*, 412 U.S. 669 (1973).

gant would not have standing to complain of a state's improperly arrogating powers attributed to the federation.<sup>29</sup> Since virtually all states, to varying extents do seek to promote investments by offering subsidies, tax breaks, and the like, no state may be inclined to bring an action of this kind. However, the states' attitudes may be changing. The National Governors Association recently adopted voluntary guidelines to place limits on these types of give aways. These programs have also been criticized on the ground that states have offered incentives in amount greatly exceeding the benefits that possibly could be gained.<sup>30</sup> Perhaps, Governor Edgar of Illinois, who has been leading critic of the state incentive programs,<sup>31</sup> may be persuaded to seek judicial sanctions instead of voluntary restraints.

Private litigants will have to construct a different legal basis for any judicial action they may attempt. Since they lack standing to complain of improper expenditure of tax receipts and of a state's invading an area reserved for federal action,<sup>32</sup> a private litigant must allege a different constitutional premise. The equal protection, privileges and immunities, and due process clauses appear to offer the most promise. Certainly, a state that affords out-of-state investors greater privileges than it extends to its residents does not show the evenhandedness that the privileges and immunities clause seeks to promote. While the principal purpose of the privileges and immunities clause is to protect non-residents against discriminatory treatment, it could be argued that it also seeks to protect residents from discrimination practiced by a state against them. However, the privileges and immunities clause has been held to protect only individuals, not corporations.<sup>33</sup>

The equal protection clause may provide an alternative basis. A resident from whom a state withholds the incentives it extends to non-residents does not receive equal protection. Here again, the peculiarity that the more extensive protection is given to non-residents need not stand in the way of reliance on the equal protection clause. It is the federal system that impels the requirement of equal protection and this equal protection should extend throughout the federal system. The Rome Treaty makes that explicit. The considerably more integrated American federal system requires no less. In any event, it would also appear violative of due process for a state to extend unequal treatment to its subjects in violation of its constitutional obligations.

4. *Harmonization of laws.* In the United States, no focussed effort has been made to harmonize laws that have a direct bearing on the functioning of an integrated market. Generally, state law reigns su-

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<sup>29</sup> See generally *Frothingham*, 262 U.S. 447.

<sup>30</sup> See *Dionne*, *supra* note 25.

<sup>31</sup> *Id.*

<sup>32</sup> *Frothingham*, 262 U.S. 447.

<sup>33</sup> *Hemphill v. Orloff*, 277 U.S. 537, 548-550 (1928).

preme.<sup>34</sup> Social legislation relating to subjects as welfare, workmen's compensation, and the like emanates from the states. The great disparities in state laws have had an immediate effect on the movement of persons, services, and capital. The more favorable welfare laws in the North have prompted wholesale migrations from the South. Recently, it was reported that large retail chains, when building stores in New York, imported construction crews from the south, because the Southern workmen's compensation premiums were only a fraction of those prevailing in New York. Although the Supreme Court has had ample opportunities to federalize, under the interstate and due process clauses, choice of law rules, these rules continue almost wholly to be state law.<sup>35</sup> The time has come for the Congress to realize that a truly integrated market needs integrated laws. The European Community has made reasonable progress in this area. The time has come for the United States to draw inspiration from its European counterpart.

5. *Antitrust rules.* Benefiting from the flexibility that a system of administrative exemption affords, the Community has imported into its system of antitrust administration both detailed regulations of particular type of anti-competitive agreements<sup>36</sup> and a measure of flexibility that the American case-by-case system of administration lacks. The Antitrust Division of the U.S. Department of Justice may draw inspiration from the European experience. In particular, the differential treatment of anti-competitive agreements between moderate size and large enterprise deserves emulation.

6. *Institutional support.* The United States should follow the community's example and substitute a federally supported program to promote the economic development of the United States as a whole rather than permit the states to compete with each other through misconceived incentive programs. A United States Investment Bank could channel development levies to the regions most in need in an economically responsible manner. Subsidies and similar support could be directed to deserving regions through a Regional Development Fund similar to the European Regional Development Fund instead of through political pork barrel deals that frequently maintain and support economically unsound and even irresponsible expenditures. It is clear, however, that this will be politically difficult to achieve.

Finally, especially in these times of economic regression and massive lay-offs, a federally funded program for retaining and otherwise assisting dislocated labor administered through a federal agency, similar to the European Social Fund, would appear to be an idea whose time has come.

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<sup>34</sup> *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938).

<sup>35</sup> *Klaxon Co. v. Stentor Electric Manufacturing Co.*, 313 U.S. 487 (1941).

<sup>36</sup> See *supra* notes 10-12.

#### IV. POSTSCRIPTUM

As the above demonstrates, the European Community provides many guides the United States could usefully follow. Only a few have here been discussed. It is remarkable, however, that the newly born Economic Community is in many ways far ahead of the two-centuries old United States.

The United States cannot afford to let the old regime continue. The European Community has identified the areas in which steps must be taken to enable an integrated market to function effectively. The United States should draw guidance from the Community's example.

The United States - Canada Trade Agreement and the proposed North American Free Trade Agreement make it imperative that the United States address the problems here discussed. The objections advanced against NAFTA to the effect that Mexico does not have the type of legislation that protects the worker, the environment, and the poor, and that generally add to the cost of production and that, as a result, it will compete unfairly with the United States for jobs and work, apply in large measure also to the relations between the states in the United States. We must eliminate these impediments to the free movement of goods, persons, and capital and would do well to begin at home and draw inspiration from the Rome Treaty.

