Trust and mutual recognition in the services directive

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Trust and Mutual Recognition in the Services Directive

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I. Introduction

To portray mutual recognition between States and central legislation only as alternatives is to give an overly static picture of their role and effects. In any realistic attempt at market-making they are intertwined and interdependent, and the concept of trust plays an important role in explaining the relation between them. In particular, whereas mutual recognition is usually said to require trust as a precondition, harmonizing legislation has trust as its effect, and sometimes its goal[313]. Yet this observation immediately shows how central legislation may in fact serve to create the conditions for decentralized mutual recognition, provided that post-legislative discretionary space remains.

Nicolaidis suggests that an important way in which legislation creates trust and promotes mutual recognition is by creating mechanisms of

'mutual monitoring' and 'reciprocal spying' which prevent States from 'cheating'[314]. The core insight is that where States have knowledge of each others rules and practices they are inhibited from adopting regulation that deviates too far from accepted norms or that fundamentally undermines the interests of their partners[315]. To do so would risk these partners calling into questions the fundamentals of the mutual recognition system, and threatening precisely the trading profits that the State is trying to win. Incomplete harmonisation, focusing on co-ordination and transparency, may therefore serve to facilitate and stabilize mutual recognition.

Kerber and Van den Bergh, among others, have described the other side of the coin, how mutual recognition promotes harmonisation[316]. They take the view that mutual recognition creates instability, a dynamic principle one of whose major functions is to provoke the vertical reallocation of powers. They point out that mutual recognition confronts jurisdictions with each other's rules, revealing and contrasting the differences. Stable mutual recognition may emerge if the differences are unimportant. However, it is just as likely, perhaps more likely in the current state of European integration, that this confrontation will serve to highlight the need for future substantive harmonisation. In other words, the extent to which States can tolerate each other's regulation is not always clear until they try, and trying may be exactly what persuades them that harmonisation is a preferable

alternative to tolerance[317]. The resulting harmonisation may be substantive, but it may also have communicative elements, aimed at increasing knowledge of each other's rules, moving from what Nicolaidis calls 'blind trust' to what she calls 'binding trust'[318]. The resulting mutual recognition may then be stretched by entrepreneurial States or economic actors until it reaches the limits of the newly established trust, leading to new calls for legislative intervention, so that, as she puts it 'a new cycle then begins'[319].

Into this context of an unstable and dynamic relationship between mutual recognition and harmonizing legislation, between the legislator and the courts, this article offers the services directive as an example of the ideas above at work. It suggests that the directive is not of great substantive import, but is primarily a communicative measure, which in turn may make the substantive rules on free movement of services – which are greatly composed of mutual recognition – effective.

II. The services directive

The services directive has been presented as an attempt to create a single market for services by laying down clear and far-reaching rules on free movement[320]. These are intended to create sufficient rights for providers, and impose sufficient constraints on public authorities, so that free movement will become a reality. Given that the continued existence of

diverse national standards and regulatory approaches within a single market can create problems of competition and consumer protection, the directive also contains feedback mechanisms aiming to provide a basis for future harmonisation to deal with these problems. The directive thus appears to envisage a sequential process that can be briefly summarized as (1) create the market (2) analyse the problems created (3) take the necessary compensating measures.

It is argued here that this is not an adequate description of how the directive will work. The primary problem of the internal market is not an absence of far-reaching free movement rules. These exist already as a result of the Treaties and the jurisprudence of the Court. Rather, the lack of free movement in practice results from a lack of motivation on the part of the States to implement these rules, a considerable room for discretion which allows States to *de facto* restrict such implementation, and an absence of any Union-level measures addressing these problems of enforcement and implementation. The rules already exist, but there is sufficient room for States to hinder their effective use, and this they do.

The directive does not address these enforcement and implementation issues and does not take the substantive rules on free movement much further than the current position. The directive will

therefore not be sufficient to directly create a single market. Its contribution to the substantive right of free movement is relatively slight.

Instead, the directive does something else. It provides for increased transparency in many ways, and for increased communication between national authorities in different States. This may help create trust between national authorities, and can be more specifically analysed using the theories of oligopoly and of regulatory competition. The limited number of States involved in the internal market suggests that the directive may encourage regulatory collusion. States may voluntarily converge towards consensual standards and regulatory approaches that protect each State against regulatory pressure from migrant businesses, their customers in the market for regulation.

It remains to be seen whether this is beneficial or not. In general, collusion enabling providers to act independently of customers is not to be welcomed, but where those providers are of laws and enjoy democratic legitimacy, whereas the customers – mobile businesses – do not, co-operation between national authorities may be a desirable counter-balance to the risks of migration-fuelled regulatory competition. Moreover, the resulting trust may lead to an increase in free movement, as States apply free movement rules more leniently and co-operatively to partner States with which they have reached a regulatory understanding.

In any case, oligopoly theory suggests that the services directive should be viewed in a slightly different light from the usual one in which it is presented. It appears to have a reflexive character, and to create a mechanism for convergence of rules which is unusual in being consensual, variable and dynamic, and entirely decentralized, and in which the Commission is potentially marginalized. The services directive may also turn out to be effective at creating an Internal Market, but via the creation of trust and understanding between States, rather than via the toughness of its rules on free movement.

The following sections elaborate on this. In turn they consider (i) the problems which a legal attempt to create a single market for services has to address; (ii) whether the directive provides an effective free movement regime, and (iii) whether its communication and information provisions will contribute to voluntary convergence, and to inter-State trust and acceptance, and thereby indirectly leads to a working single market.

III. The problems of the single market for services

Insofar as the absence of a working single market for services can be attributed to legal failure, that failure can be most plausibly located in one or both of two places. On the one hand, it is arguable that the rights of free movement on which the market is based are insufficiently clear or far-

reaching; they do not sufficiently constitute the market. On the other hand, whether or not those rules are in principle adequate, it is arguable that States do not implement or comply with them with enough enthusiasm or good faith, and the rules are not sufficiently enforceable to overcome the obstacles that this lack of national goodwill creates. The problems can thus be divided into those of substance, and those of enforcement and implementation.

Sustaining both of these problems is a deeper, non-legal one, which may be called the problem of trust. States are not motivated to fully apply free movement rules, because they do not have faith that this is in their own interests, for a number of reasons. They exploit the defects of the law because they can, and because they want to. This is something that requires attention in itself.

A. Inadequacies in the substantive rules

Under the current interpretation of the Treaty, the application of any national measure which might tend to make the cross-border provision of services or establishment less attractive, or might hinder it in any way, is in principle prohibited unless the State in question can show that the application is necessary to achieve a justified goal, and is proportionate[321]. A body of case law makes clear that proportionality is to be interpreted in a free-movement-friendly way, and the Court subjects national measures to strict, even

sceptical, scrutiny[322]. In the course of interpreting proportionality it has laid down a number of rules to this effect. For example, national rules must not attempt to duplicate requirements contained in home State laws[323], administrative requirements on service providers must be cheap, simple, and completion may not be a pre-requisite for starting work[324], and the consumer must be treated as reasonably self-sufficient, so that imposition of paternalistic standards will not be permitted[325].

In substance, these comprise a far-reaching market manifesto, and full compliance would result in a market in which movement between States was hardly more difficult than internal movement. In fact this is a formulation that the Court has on occasion used; application of rules making cross-border movement harder than domestic is prohibited[326]. There is the market then; *Voilà*! If compliance could be assumed, the market would exist already.

However, a practical problem with the substantive law is its high degree of abstraction. What is 'justified' and 'proportionate' is open to argument, and while a distinct philosophy emerges from the case law of the Court of Justice, this is less accessible and forceful than explicit and specific rules would be[327]. Moreover, the Court links its decisions to the individual facts, meaning that it is always open for a Member State to argue that the facts in a subsequent case justify drawing the line in a different place[328].

Necessity, justification and proportionality remain negotiated, ambiguous, open-textured concepts.

Moreover, the status of judicial interpretations as law is not self-evident in all Member States. The degree to which the Court of Justice's pronouncements should be abstracted and treated as generally binding interpretations of the Treaty – even if expressed as such is not settled decisively as a matter of doctrine[329]. Nor, as a matter of practice, can judicial statements be expected to have the same general impact on regulatory authorities as a written law would have.

To the EU specialist, the substantive law is therefore remarkably complete and powerful. The 'right' interpretation – that the Court of Justice would give in a case – is not too hard to predict, and it allocates free movers a high degree of protection against national regulatory hindrance. However, that law is not formulated in a way that will have maximum practical impact on the authorities required to apply it, and so does not fulfil its own potential.

B. The problems of implementation and enforcement

If States simply snub their noses at the law then one might speak of legal delinquency, and the solution would not necessarily lie in better rules but in enforcement mechanisms. However, there are ways of resisting full

application that fall short of such outright legal rebellion[330]. Primarily, in the context of the internal market, States may take a stance on the ambiguous concepts of necessity, justification and proportionality that is favourable to national interests or the regulatory *status quo*, and relatively unfavourable to free movement. By doing so they can effectively block free movement by continuing to apply restrictive national rules, claiming that these are genuinely necessary and justified.

The State might lose if the matter is appealed all the way to the Court of Justice, but this is barely relevant in practice. Firstly, commercial reality entails that service providers do not have years to spare for a protracted legal fight. Thus, in practice the initial position of a State on the legitimacy of its national laws is the one that the service provider will generally have to live with. The theoretical possibility of legal challenge, particularly given the speed of most legal systems, not to mention costs, is not a viable basis for a working free movement regime. Secondly, even if legal challenge does result in a rejection of the State's regulatory provision and a vindication of free movement, the State is still able to treat the judgment as restricted to the facts, and to continue its restrictive behaviour in other spheres.

Member States are therefore able to exploit the lack of clarity of the law to claim that particular restrictive measures are in fact necessary and proportionate. Debunking such conservative readings of the law requires

engagement with the nuances of EU law, which in reality entails an impractical level of litigation. The ambiguity of free movement law is therefore widely seen as a major reason for its limited effectiveness in practice[331].

EU law does not address these enforcement problems . It does require that judicial protection of EU rights be 'effective', and the Court – and the directive – have laid down some further requirements[332], but the standards resulting do not require a legal process sufficiently speedy and accessible to meet the demands of commercial reality for small to medium-sized service providers. Nor could this be so; it would amount to a revolution in domestic legal systems.

Most importantly, nothing in EU law makes it wrongful for a State to consistently take a conservative approach to the interpretative space that the law offers. The fact that time after time States take positions that EU law specialists consider highly unlikely to survive the scrutiny of the Court of Justice does not in itself amount to a violation of EU law, nor attract punishment or criticism from the Court of Justice or Commission. Each case is decided on its merits, and the fact that a State has fought and lost analytically similar cases in the past is not relevant to the outcome, nor even to a claim for damages, unless those cases are so similar as to be identical – which given the open texture of the law is always arguably not the case[333].

The sanction for a wrongful standpoint is generally no more than being required to change that particular standpoint if the case is ultimately litigated and lost.

The fact that a State consistently takes losing legal positions on free movement is therefore merely part of the legal game. This is probably inevitable. The same applies to appeals within a domestic legal system; the fact that a judgment is overturned on appeal, or even that a court finds its judgments often overturned on appeal to the extent that it attracts a reputation as particularly conservative or radical or whatever, does not render that court or its judgments illegitimate or subject to sanctions. Respect for judicial independence is too high to permit this. A similar logic may be applied to national regulatory authorities. Moreover, the problem is not just with such authorities. National judges tend to defer to governmental assessments of necessity and proportionality[334], and once again, the mere fact of being consistently wrong does not attract sanctions.

Given the room which the open-textured nature of free movement law leaves for interpretation there is therefore nothing in EU law to prevent national authorities and courts from consistently taking conservative and free movement-unfriendly positions with respect to the application of national rules. They are in principle obliged to follow the Court's interpretations, but are neither sanctioned nor prevented if they interpret

autonomously and divergently. *De facto*, EU law does not guarantee free movement rights.

C. The problem of trust

Although the law leaves room for States to resist free movement, this does not necessarily mean that they will choose to do so. However, the fact that a single market for services is not considered to exist suggests that to a considerable extent such resistance does occur.

This situation may be described by saying that States and national authorities clearly exercise their interpretative discretion in a way that favours national interests more, and free movement less, than EU law would prefer. There is obviously a perception in the States that maximizing free movement by seeking to minimise the obstacles caused by national regulation is not in fact in the national interest or in the interest of the regulatory authority in question and/or its direct clients.

The most obvious basis for this view is the perception that other States do not regulate adequately, or as well as the host State, so that admitting foreign service providers without subjecting them to the full range of national regulatory demands undermines quality on the local market to the detriment of local consumers. This perception is not likely to be based on a deep knowledge of foreign rules or inadequacies, but is the result of a

precautionary approach which in turn is probably based partly on a presumption of local superiority, and partly on the natural inertia and suspicion of non-conformity that one may attribute to institutions generally.

However, it is suggested that this concern for consumers is not likely to be the major motivation for restricting market access. Consumer protection is often a repackaging of concerns about unfair competition, and in these cases the primary objection to exemption from local rules for foreign economic actors is the perception that this is unfair[335]. This is partly based on the substantive argument that through exemption they gain a market advantage over domestic competitors, by being subject to a lesser regulatory burden, and partly based on the formal view that all should be treated identically, a view which has strong European roots and has considerable legal and philosophical capital in the Member States[336]. There is a resistance to the argument that because some actors are different they deserve to be treated differently. In this case that argument would suggest that those subject to the regulation of their home State deserve to consequently have a different status under the regulation of the host State, but the concept of exemptions for difference is resisted on far more general and philosophical grounds, linked to matters such as the unity of the State and the blindness of public authority to categories of citizens[337].

Less philosophically and more practically, national authorities may resist to free movement out of concerns about where it will take them. The idea of special legal treatment for foreign-based providers entails a form of regulatory competition which is highly contested, and in fact probably rejected by most members of the European political class and the European public[338]. It raises the spectre of the race to the bottom, and States may resist free market access because they fear that if they are too open they will (a) encourage domestic firms to relocate abroad to low-regulation States, and (b) be participating in a game which will lead to a spiralling down of regulatory standards, not only harming national interests but also reducing national control over the quality of national markets[339]. Regulatory competition is a significant threat to the substantive regulatory autonomy of States, and it is hardly surprising therefore that they seek to resist forms of free movement which entail this[340]. Indeed, one of the issues which the law of the internal market has failed to address adequately is the fact that regulatory authorities often do not in fact appear to accept the fundamental principles upon which the internal market is based; that economic actors should be able to operate throughout the EU while only being subject to a single regulatory jurisdiction. By contrast, both governments and the public are probably more sympathetic to a 'when in Rome do as Romans do' rule;

if you want to do business in X, comply with its rules[341]. The justice of this is certainly easier to explain and to grasp.

Finally, there is the issue of reciprocity. While economists may suggest that it is beneficial to open one's markets even if partner States do not do the same, this view does not attract much political support. Given the weaknesses of the law, open markets are not beyond question, and it may be assumed that States fear that if they are too obedient to EU law for their own good they will be in the position of having their domestic markets 'plundered' by foreign providers while their own providers will be unable to gain access to markets abroad. This is a situation which could be analysed in game theoretical terms. Even if States believe in open markets generally, given that they also believe in reciprocity they are unlikely to make the first move unless they have some mechanism for protecting themselves against misuse of this generosity by their neighbours. This protection could lie in the possibility to reclose markets, but a sense of protection could also arise from a mechanism for creating trust between authorities in different States.

The problems may be summarized by saying that there is a lack of trust in foreign standards, and a lack of faith in the concepts underlying the EU market regime and in that regime as a whole[342]. States do not appear to feel confident that opening their markets to non-compliant service providers from other jurisdictions will not lead to serious local economic and social

harm, largely because they fear that other jurisdictions do, or will, adopt low standards, and that they will be caught in the pincer between the need to prevent businesses leaving the country, and the desire to regulate in accordance with local preferences.

D. Ways of addressing the legal problems

Measures to increase the effectiveness of free movement law might take one of a number of forms. The most obvious would be to reduce the ambiguity which enables national resistance. This could be done by legislation spelling out the content of free movement law in a more precise and specific way. It could also be done by giving a procedural content to the assessment of necessity, justification and proportionality[343]. Providing lists of relevant factors and guidelines for their use would constrain national authorities and result in less deviation from the Court's preferred interpretative approach.

Another way of increasing effectiveness would be for EU law to directly address the procedural problems of enforcement – for example requiring extra-speedy judicial processes or appeals, or imposing a presumption of free movement rights while a case is pending. This approach is unlikely to be followed because of the degree to which it imposes on national legal systems and domestic procedure.

A third way is to address the issues of trust and motivation, to create a situation in which States perceive opening their markets to foreign service providers to be in their own interests, or to raise no or limited conflicts with other interests.

The following two sections consider the extent to which the services directive offers any solutions such as these.

IV. The services directive as a regime for free movement and regulatory competition

The directive is presented as legislation promoting free movement by enacting free movement rights. This view is unsatisfying for three reasons. Firstly, the directive barely changes the existing law. Secondly, its limited scope means that even if it is implemented in good faith it does not address a sufficient range of issues to be properly market-opening. Thirdly, there is little reason to think that its rights will be harder than those of the Treaty, since there is a continued avoidance of enforcement and implementation issues. It is true that the fact of setting rights out in legislation may encourage a fuller adoption of them than would be the case if they remained products of case law, but given the limitations of the substance of the directive this is not enough to rebut the conclusion that the directive does not

provide sufficient or even particularly significant legal support for free movement.

E. Does the directive take the law any further?

The chapter on freedom of establishment is in substance an enactment of the Court's interpretation of Article 49 TFEU.[344]. It requires, as does the Treaty, in the view of the Court, that measures restricting access to the provision of a service as an established person must be justified by the pursuit of a legitimate interest, necessary for this, and proportionate. The chapter sets out lists of examples of measures which would be prohibited and which should be regarded with suspicion, but there is nothing in these lists which would surprise a lawyer[345]. The prohibited measures are ones that have long been prohibited as a result of judgments of the Court. The doubtful ones are to be assessed in the light of the principles of justification and proportionality again.

Thus while the codification of the case law may have a certain clarificatory value, this should not be overstated. The codification has been done in a relatively banal way, with the most obvious points being spelt out, but the more difficult points – what exactly is necessary and/or proportionate? – continuing to be left open. The room for interpretation,

dispute, and *de facto* restriction of movement is therefore little changed from what it was before the directive[346].

The services chapter has attracted attention for its appearance of progress. While no longer referring to the country of origin principle, it essentially maintains it in substance. It restricts the application of host State service rules to foreign providers to such an extent that they are in principle, within the sphere of the directive, almost as good as exclusively regulated by their home State. Host State rules can only be applied where justified by public policy, security, health or the environment, and the probability is, given the way these concepts have been interpreted in the past, that they will continue to be strictly enough interpreted that one may speak of exceptional derogations from the general rule of exclusive home State control.

Yet, alongside this far-reaching general idea a number of provisos must be placed. Not least is the fact that the difference between the country of origin principle and the existing Treaty rules interpreted into Article 56 TFEU is not so great. Currently Member States are entitled to apply national measures to foreign service providers wherever justified, necessary and proportionate, which seems open-ended, but in practice the Court has been restrictive, and the litigation success rate of States is low. While, for example, consumer protection is often cited as a reason for restricting market access which the services directive takes away, there are few cases in

which it has actually been successfully relied upon[347]. Thus the legal principle contained in the directive is really very close in practice to the legal principle found in the existing case law – the more extensive derogations from free movement which are presently permitted tend to be unsuccessful anyway[348].

Nevertheless, the fact that these cases on consumer protection were brought indicates that the open-ended justifications which the case law permits provided an opportunity for conservatism on the part of States. Given that, as it has been argued above that the commercial disadvantages of litigation often give States effective ownership of open-ended concepts, removing some of those concepts is likely to aid free movement. However, this is mitigated by the fact that as a result of narrowing the category of exemptions to free movement, the ones that remain are likely to become more contested. If public policy remains the only justification for derogation then we will probably see States straining to expand this concept and bringing ever more arguments within it[349]. Since the limits and definitions of public policy are as potentially open-textured as any others – 'sufficiently serious threat to a fundamental interest of society, 'interpreted strictly', 'proportionate' (…)[350] – the challenge of preventing national authorities from misusing interpretative spaces for an over-restrictive approach to free movement has not been met.

A criticism of both the establishment and services chapter is that they only appear to apply to a limited class of public measures: those restricting 'access to a service activity'[351]. This may be contrasted with the broader Treaty prohibition which, in the eyes of the Court, covers 'any measure which may hinder or make less attractive' the exercise of free movement[352]. The distinction lies in measures which do not directly concern access to a service activity as such, but do in fact make it harder to provide services abroad. These could be aspects of planning rules, the legal system, vehicle and property use, the integration of the family of the service providers, and tax issues, to which the directive will not apply. Given that services are provided by people or organisations which must exist as people or organisations, as well as engaging in their service activity *pur sang*, the directive is not wide enough in scope to function as a real market opener[353]. It does not even pretend to address the full range of legal factors which in fact make it harder to supply services abroad. As a result, service providers will often have to fall back on the Treaty articles to establish the legal rights necessary for their activities, an undesirably messy legislative position[354].

F. Enforcement and implementation again

Although the directive does not substantially develop the substantive law, and is even narrower than the Treaty in some ways, it may stimulate national authorities to take account of free movement rights simply by virtue of being

a directive, explicitly addressed to them[355]. Commanding the attention of the national regulator is a useful, if insufficient, step in enforcing the law.

The administrative provisions of the directive may also help with practical enforceability. These require States to make the administrative procedures associated with access to a service activity 'sufficiently simple', and accessible via a single point of contact, which must include an online contact point[356]. This should make it easier for service providers to establish what their legal position is, and encourage them to assert rights. An assertive approach is more probable where providers have a clear line of communication with the authorities, and do not feel lost in a sea of bureaucracy.

Nevertheless, these are rearguard arguments. Neither the mere fact of being written law, nor the simplification of the bureaucracy associated with cross-border movement address directly the continued weaknesses and ambiguities of the substantive law. It is difficult to believe that the delays and difficulties associated with dealing with local authorities are in themselves a significant enough obstacle to movement that addressing them in this procedural way will fundamentally change the level of market integration.

V. The services directive as a mechanism for inter-state co-operation

The services directive may not provide adequate free movement rights directly, but it does create mechanisms through which Member States can communicate with each other about issues and concerns relevant to service activities[357]. Looking at these mechanisms in the light of theories about competition suggests they may be effective in helping create inter-State consensus over levels and types of regulation and in helping States accept each others' rules and service providers. The directive may therefore contribute to free movement via an indirect – second order – mechanism. It can be seen as a type of reflexive law, encouraging States to react constructively to each other and converge voluntarily and flexibly[358].

G. A regulatory oligopoly

The starting point for this perspective is a view of Member States as sellers on a market for regulation; each State offers its rules and hopes that this will attract and stimulate economic actors, who will use the State as a base for their service provision throughout the EU[359]. This is often described in terms of regulatory competition, and it is the fear of many that such competition between States may lead to a race to the bottom[360]. Precisely, the hard free movement rights to which the directive is often presented as containing raise

this risk, because they make it possible for companies to choose their State of establishment independently of the location of their customers.

However, not all markets function perfectly, and the market for regulation within the EU has some of the characteristics of an oligopoly – a relatively small number of providers dominate the market. In this case, the number of providers of regulation has a ceiling of the number of EU Member States.

In oligopolistic markets the risk arises that the providers either collude – form a conscious cartel – or that they engage in non-collusive parallel behaviour – they converge in products and prices even without explicit agreement to do so[361]. The result of either path may be that the providers collectively take on the characteristics of a dominant market actor, able to act to a significant extent independently of consumers – who are in this case the service providers subject to the regulation[362]. The risk of regulatory competition, by contrast, is that States become enslaved to migrating companies, who can dictate the terms of regulation[363]. The reply in terms of oligopoly is that by collusion or natural parallel behaviour States may once again assert their independence of those companies, and be able to act in their own interests – or those of their voters.

However, such oligopolistic parallelism does not happen in all markets. A number of factors make it more or less likely[364]. The first of

these is the number of sellers in the market, and on the whole a smaller group is more likely to act as one than a larger group. The number of Member States in the EU, currently 27, is on the high side for either collusion or parallelism. However, for many kinds of service the EU may not be one market. For reasons of infrastructure, language, the availability of staff, physical location, among other issues, not every jurisdiction will be able to plausibly compete for the headquarters of all service providers. Thus for any given service in any given part of the EU there may be a smaller number of jurisdictions that are realistic options for establishment, and that are therefore in competition with each other. The EU may in fact consist of multiple smaller overlapping services markets.

A second factor which is considered to make collusion or parallel behaviour much more likely is the availability of information about what competitors are doing. It is sometimes possible for parallel behaviour to occur entirely without contact between firms if one makes clear pricing and policy announcements, and so behaves as leader for the others, who understand implicitly and independently that it is in their interests to follow the leader rather than undercut it. If there is contact between market actors this increases further the chance of non-competition.

A large part of the services directive is devoted to increasing transparency and making information about regulatory demands available[365].

The administrative chapter is aimed at making requirements clear for service providers[366], but if the information is 'out there' on clear websites, as is the intention, it will be equally available to the authorities of other States. It seems plausible that at the moment most national authorities have relatively little knowledge of the details of regulatory requirements of other States, and the publication of the details to providers will also raise the level of information available to sister-authorities significantly. Additionally, the directive contains provisions requiring communications networks to be set up between national regulatory and supervisory authorities[367]. This is expressed to be primarily for the purpose of assisting each other with the supervision of specific providers, and exchanging information about reputability and so on. However, the fact that channels of communication are being created and kept open is likely to lead to an enhanced understanding of each other's regulatory content, methods, and philosophy in general, as well as of plans for changes and developments. Almost inevitably, the creation of this network will be the beginning – or in some cases further development – of a conversation between regulatory authorities.

The third of the major factors determining the behaviour of oligopolists is the possibility to sanction members who depart from the terms of (implicit) agreements. The cartel that can sanction its members is

much more stable than one which cannot, while if there is a potential price to be paid for non-parallel behaviour then market actors are more likely to continue along the parallel path.

Here the weakness of the services directive – that it does not actually guarantee free movement – becomes one of its key points. Under the regime that it introduces free movement continues to be conditional upon the good will of the host State, for all the reasons discussed above. However, the conversation about free movement is, as a result of the communicative provisions of the directive, no longer just between the service provider and the host State, but between national authorities. These speak to each other directly about service regulation, and so implicitly, and probably explicitly, about access to each others' markets. Free movement was never guaranteed, and is still not guaranteed, but has changed from being conditional, to being negotiated. As authorities speak to each other they learn of each others' concerns – and these are probably largely shared – and of the reasons each may have to take a restrictive approach to service providers, and are capable of adapting to these reasons either by providing information to allay fears, or by adapting rules to meet concerns, or by offering deals – you take it easy on our management consultants and we'll not be too difficult about your architects. All of these strategies are likely to be used together, so that each

State is effectively engaged in negotiating market access with its fellow member States.

The sanction is then that a State[s] which chooses to go its own regulatory way, without concern for the consensus of other States, may find that its providers have difficulty operating in other States. This need not be as a result of any conscious retribution. However, if there is a regulatory consensus about the proper level of protection or types of acceptable constraint, then a State will feel more confident and justified in interpreting e.g. public policy, justification or proportionality in a way that excludes providers departing notably from this consensus, or subject to a supervisory jurisdiction that does so. There is safety in numbers, and the possibility for consensus between many States makes it more likely and more defensible that non-conforming States will pay a price in market access. Added to this may be a price in political isolation. States playing the regulatory competition game at its hardest will not be pleased if other States are able to form a well-informed oppositional front. One may note finally that communicated consensus between States may strengthen their position even if service providers – or the Commission – do choose to litigate. The Court of Justice must itself then interpret the open norms, and a broad European consensus for a certain view is likely to carry more weight than an argument from a uniquely mono-national point of view.

H. Collusion or democratic co-operation?

The outcome of an oligopolistic market with high levels of communication and sanction is likely to be, in the absence of countervailing factors, co-ordinated behaviour[368]. In the context of a market for regulation it seems likely that some degree of convergence of regulation will occur, as States realize that locating their regulation within a consensus band is in their own interests, as it prevents competition between them.

In a conventional market this would be seen as undesirable. However, in a conventional market the concern is usually to maximize the welfare of consumers, and to prevent sellers from organizing to hinder that goal. In a context of regulatory competition matters change somewhat. The consumers of laws are service providers, whose welfare is a concern, but by no means the exclusive or even major concern of policy in this area. By contrast, the end consumers of the services are democratically represented in the States – the sellers of law – giving these a legitimacy that they do not have in a normal market. The situation requires more careful analysis.

In the absence of international trade rules, States can make their own trade-offs between the costs and benefits associated with opening their markets, and different levels of regulation[369]. Low regulation may stimulate economic activity, but bring unwelcome consequences. High regulation may serve some consumer interests, but hinder economic activity. Opening the

national market to foreign providers may create the risk of domestic producers locating abroad where regulation is lighter, but may also result in increased domestic competition and lower prices. All are legitimate factors to take into account.

However, if trade rules constrain a State to open its markets at least to some non-trivial extent – as both the Treaty the directive do – then that State loses the capacity to balance interests exclusively according to the preferences of its population[370]. One may hope that the joining of the trade area and the submission to the trade rule is a preference of the population, so that this is a non-issue, but in practice it is never quite so simple; populations would ideally like to be members of the trade area but not take all the consequences all of the time.

Giving States the capacity to co-operate and thereby gain a certain independence of migrating companies restores some balance to their policy-making capacity. If the goal is that States are able to make policy reflecting the preferences of their populations then it may be advantageous. Yet while the resulting convergence to a consensus may reflect preferences better than an unfettered race to the bottom would, it may nevertheless not be optimal. The tendency of colluding sellers is to keep prices too high, and the tendency of co-operating States, freed from pressure from the consumers of their laws, may be to undervalue the advantages of limited regulation, and

overvalue their own institutional interests in a strong State-administered regulatory system.

I. Variable and flexible co-operation

An apparently attractive aspect of the situation created by the directive is that it allows for variation and change within the overall framework of a movement towards consensus. A State that wishes to go its own regulatory path is still able to in any given area, while converging on others, provided it is prepared to accept the possible price in access and isolation. While the result of communication may be convergence, this is voluntary, and so reversible. Moreover, it need not be full convergence; the degree to which States are prepared to accept diversity is negotiable and dynamic, and may change and broaden as they come to understand each other better. Initial reactions to mutual learning may be an eagerness to agree terms, but as trust deepens States may be more and more able to accept divergent regulation. Collusion is an utterly flexible mechanism.

VI. Conclusions

It is a difficult empirical question, beyond the scope of this article or the expertise of its author, whether communication and co-operation between States will in fact lead to optimal regulation or how far it will diverge from

the optimum. However, whatever the outcomes, three *a priori* points may be made about the mechanisms involved, based on the preceding discussion:

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Firstly, the relationship between the directive and the market for services is not what it is commonly presented to be. The conventional presentation is that the directive creates free movement; this leads to regulatory competition, which in turn may lead to agreement to Commission-led harmonisation. In fact, it is suggested that a more important sequence will be as follows: authorities communicate and learn about each other, this leads to convergence of regulation and acceptance of regulation, and as a result they open their markets to each others' providers. Limited voluntary harmonisation therefore leads to free movement, rather than free movement leading to traditional EU harmonisation.

Secondly, the absence of the EU or the Commission in the mechanism described is striking. While the directive envisages that the States and the Commission will together form an information network with a view to harmonisation where necessary, in fact the role of the Commission may be marginalized. If States are able to work together then they may see no need for true harmonisation, and resist the loss of autonomy and flexibility that it entails.

Thirdly, it is open to doubt whether an oligopolistic market for regulation is optimal, but it is worth noting that this market will be a dynamic and unstable one. The States collectively gain power as a result of co-operation, but that does not mean that actors such as firms and the Commission are entirely removed of influence. For one thing, even where there is a functioning consensus there is likely to be relative dissatisfaction in some States, who would rather locate the consensus elsewhere. Thus a role for traditional harmonization, or intervention from Brussels is not completely absent. By strategic intervention both the Commission and industry lobbies can do something to counteract a possible tendency among colluding States to over-value selected interests and ignore others.

In summary, trust, legislation, mutual recognition and market-making are inter-dependent. Developments in one affect all of the others. Effective legislation or policy uses this fact to achieve indirect – second order – as well as direct results. The Services Directive provides only a mildly reformed framework for substantive mutual recognition, but a greatly enhanced framework for trust and communication. It seems likely that this will contribute to the effectiveness of mutual recognition and market operation, and ultimately promote more selective, but more achievable and useful, and perhaps often voluntary, harmonisation.

Notes

[313] This formulation is taken from the presentation by Prof. R. Bachmann at the *Modern Law Review* workshop on The Regulation of Trade in Services: 'Trust, Distrust and Economic Integration', held in London and Cambridge in June 2009. I am grateful to the participants of this workshop for discussion and comments.

[314] K. Nicolaidis, 'Trusting the Poles? Creating European through Mutual Recognition', *JEPP* 14(5) (2007), 682–698, p. 683.

[315] Ibid.

[316] W. Kerber and R. van den Bergh 'Mutual recognition revisited: misunderstandings, inconsistencies and a suggested reinterpretation' *Kyklos* 61 (2008) 447–465; G. Davies 'Is Mutual Recognition an Alternative to Harmonisation? Lessons in Tolerance and Trade from the European Union for the WTO and other RTAs' in: F. Ortino and L. Bartels (eds.) *Regional Trade Agreements and the WTO* (Oxford: OUP, 2006) pp. 265–280.

[317] G. Davies 'Is Mutual Recognition an Alternative to Harmonisation? Lessons in Tolerance and Trade from the European Union for the WTO and other RTAs', above.

[318] K. Nicolaidis, above, p. 683.

[319] Ibid.

[320] Directive 2006/123/EC of the European Parliament and of the Council on services in the Internal Market OJ (2006) L 376/76.

[321] Case C-55/94 *Gebhard* [1995] ECR I-4165; Case C-76/90 *Säger and Dennemeyer* [1991] ECR I-4221.

[322] S. Weatherill, 'Protecting the Consumer Interest in an Integrated Services Market', *Mitchell Working Paper 1/2007*, available at http://www.law.ed.ac.uk/file_download/series/23_promotingtheconsumerinterestinanintegratedservicesmarket.pdf, 2 (last visited September 26, 2010).

[323] Case 279/80 *Webb* [1981] ECR 3305.

[324] Case C-58/98 *Corsten* [2000] ECR I-1919.

[325] Case 120/78 *Cassis de Dijon* [1979] ECR 649; S. Weatherill, *EU Consumer Law and Policy* (Cheltenham: Edward Elgar, 2005).

[326] Eg. Case C-422/01 *Skandia* [2003] ECR I-6817; Case C-281/06 *Jundt* [2007] ECR I-12231.

[327] See S. Weatherill, 'Protecting the Consumer Interest in an Integrated Services Market', above, pp. 12–15.

[328] Ibid.

[329] G. Davies, 'Abstractness and Concreteness in the Preliminary Reference Procedure' in: N. Nic Shuibhne (ed.) *Regulating the Internal Market*

(Cheltenham: Edward Elgar, 2006) pp. 233–236 (also available as 'The Division of Powers between the European Court of Justice and National Courts' on ssrn.com).

[330] See generally F. Snyder, 'The Effectiveness of European Community Law: Institutions, Processes, Tools and Techniques', *MLR*, 56(1) (1993), 19–54.

[331] S. Weatherill, 'Protecting the Consumer Interest in an Integrated Services Market', above, pp. 12–15; J. Pelkmans, 'Deepening Services Market Integration – a Critical Assessment', *Romanian Journal of European Affairs*, 7(4) (2007), 5–32, section 4.2 (also available on ssrn.com); B. De Witte 'Setting the Scene: How did Services get to Bolkestein and Why?' *Mitchell Working Paper 3/2007*, available at http://www.law.ed.ac.uk/file_download/series/28_settingthescenehowdidservicesgettobolkesteinandwhy.pdf , 6–7 (last visited September 26, 2010).

[332] See S. Prechal 'Free Movement and Procedural Requirements: Proportionality Reconsidered', *LIEI* 35 (2008), 201–216; C. Barnard, 'Unravelling the Services Directive', *CMLRev*, 45 (2008), 323–394, pp. 354–356.

[333] Case C-224/01 *Köbler* [2003] ECR I-10239; Cases C-46 and 48/93 *Brasserie du Pecheur* [1996] ECR I-1029; Case C-129/00 *Commission v Italy* [2003] ECR I-14637.

[334] M. Jarvis, *Application of EC Law by National Courts: Free Movement of Goods* (Oxford: Clarendon Press, 1998), pp. 220–221.

[335] Eg. Case C-384/93 *Alpine Investments* [1995] ECR I-1141; Case C-134/04 *Commission v Italy* [2007] ECR I-6251; Cases C-94/04 and C-202/04 *Cipolla and Others* [2006] ECR I-11421.

[336] See E. T. Beller, 'The Headscarf Affair: The Conseil *d'État* on the Role of Religion and Culture in French Society', *Texas International Law Journal*, 39 (2004), 581–623; T. J. Gunn, 'Religious Freedom and Laïcité: A Comparison of the United States and France', *Brigham Young University Law Review*, (2004) 419–506; M. Mahlmann, 'Religious tolerance, Pluralist Society and the Neutrality of the State: The Federal Constitutional Court's Decision in the Headscarf Case', *German Law Journal*, vol. 4 issue 11 (2003), 1099–1116.

[337] Ibid.

[338] See B. de Witte, 'Setting the Scene: How did Services get to Bolkestein and Why?', above, pp. 9–10.

[339] See J-M. Sun and J. Pelkmans, 'Regulatory Competition in the Single Market', *JCMS*, 33 (1995), 67–89.

[340] See F. Scharpf, 'Economic Integration, Democracy and the Welfare State', *JEPP*, 4 (1997) ,18–36.

[341] K. Nicolaidis and G. Schaffer, 'Transnational Mutual Recognition Schemes: Governance without Global Government', *Law and Contemporary Problems*, 68 (2005), 263–317.

[342] See K. Nicolaidis, 'Trusting the Poles? Creating European through Mutual Recognition', *JEPP* 14(5) (2007), 682–698.

[343] See G. Davies, 'Abstractness and Concreteness in the Preliminary Reference Procedure', above, p. 232.

[344] There is a consensus on this. See eg. S. Weatherill, 'Protecting the Consumer Interest in an Integrated Services Market', above; C. Barnard, 'Unravelling the Services Directive', above; S. Griller 'The Services Directive: Two Steps Forward, How Many Back' in: F. Breuss, G. Fink and S. Griller *Services Liberalisation in the Internal Market* (Vienna: Springer, 2008) p. 225.

[345] Articles 9–15, Directive 2006/123.

[346] S. Weatherill, 'Protecting the Consumer Interest in an Integrated Services Market', above, pp. 12–15; J. Pelkmans, 'Deepening Services Market Integration – a Critical Assessment', above, Section 4.2; S. Griller, 'The Services Directive: Two Steps Forward, How Many Back', above.

[347] C. Barnard, 'Unravelling the Services Directive', above, p. 367; S. Weatherill, 'Protecting the Consumer Interest in an Integrated Services Market', above, p. 2.

[348] Similarly, V. Hatzopoulos, 'Legal Aspects in Establishing the Internal Market for Services', *College of Europe Research Paper in Law 6/2007*.

[349] C. Barnard, 'Unravelling the Services Directive', above, p. 366. Cf. the plausible argument popular on the continent that the mandatory requirements will and should be interpreted into Article 16 just as they were interpreted into the almost identically worded Article 49 EC; V. Hatzopoulos, Legal Aspects in Establishing the Internal Market for Services', above; J. Pelkmans, 'Deepening Services Market Integration – a Critical Assessment', above ; G. Davies 'The Services Directive: Extending the Country of Origin Principle and Reforming Public Administration', *ELRev*., 32 (2007), 232–245, p. pp. 235.

[350] Case C-36/02 *Omega Spielhallen* [2004] ECR I-9609.

[351] Article 9(1); Article 16(1).

[352] Case C-55/94 *Gebhard* [1995] ECR I-4165.

[353] Cf. C. Barnard, 'Unravelling the Services Directive', above, pp. 336–339.

[354] See also C. Barnard, 'Unravelling the Services Directive', above, pp. 343–344.

[355] Ibid., pp. 393–394.

[356] Article 5–8.

[357] See Articles 28–36. See also Articles 7 and 21.

[358] S. Deakin, 'Two Types of Regulatory Competition: Competitive Federalism versus Reflexive Harmonisation. A Law and Economics Perspective on Centros', *CYELS*, 2 (1999), 231–260.

[359] See generally, A. Ogus, 'Competition between National Legal Systems: A Contribution of Economic Analysis to Comparative Law', *ICLQ*, 45 (1999), 405–418.

[360] For an overview in the EU context see, C. Barnard and S. Deakin, 'Market Access and Regulatory Competition' *Jean Monnet Working Paper 09/01*, available at http://centers.law.nyu.edu/jeanmonnet/papers/01/012701.html (last visited .September 26, 2010)

[361] See eg. G. Monti, *EC Competition Law* (Cambridge University Press, 2007), pp. 308–311.

[362] See A. Ogus, 'Competition between National Legal Systems: A Contribution of Economic Analysis to Comparative Law', above. The definition of dominance is from Case 85/76 *Hoffman La Roche* [1979] ECR 461. See also G. Monti, 'The Concept of Dominance', *European Competition Journal*, 2 (2006), 31–52.

[363] See C. Barnard and S. Deakin, 'Market Access and Regulatory Competition', above.

[364] See A. Jones and B. Sufrin, *EC Competition Law* 3rd ed. (Oxford: OUP, 2008), pp. 871–873.

[365] See Articles 7, 21, 28–36.

[366] Chapter II of the Services Directive.

[367] See Articles 28(2), 32(2), 34.

[368] See footnote n 52 above.

[369] See J-M. Sun and J. Pelkmans 'Regulatory Competition in the Single Market', above; R. van den Bergh, 'Towards an Institutional Legal Framework for Regulatory Competition in Europe', *Kyklos 53* (2000), 435–466; M. Trebilcock and R. Howse, 'Trade Liberalisation and Regulatory Diversity: Reconciling Competitive Markets with Competitive Politics', *European Journal of Law and Economics*, 6 (1998), 5–37; J. Trachtman, 'International Regulatory Competition, Externalisation, and Jurisdiction', *Harvard International Law Journal*, 34 (1993), 47–104.

[370] Ibid.