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Competition Policy and Trade Policy in the European Union[1]

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Three decades of experience in the European Union (EU) provide materials of incomparable richness for our efforts to define the relative realms of competition policy and trade policy. Faced with the challenge of creating a common internal market, free of barriers to the movement of goods, services, labor, and capital, the Union has fashioned and applied instruments of competition policy and trade policy without precedent. In the process, it has highlighted the institutional requirements to be met and the policy issues to be overcome when a region attempts to enlarge the role of competition policy and to shrink that of trade policy.

The Union as a Laboratory

Before the six charter members of the European Community (EC) (later to be a part of the European Union) agreed to its terms in 1957, nothing quite like it had existed in the annals of international economic relationships.

By the terms of the Treaty of Rome, which created the European Community, the member states agreed to relinquish to it their powers

1. Yun W. Choi made a substantial contribution to this paper with an extensive analysis of major cases arising in the European Community and under the General Agreement on Tariffs and Trade. Minghong Lu and Mingcheng Lian also provided valuable research support.

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to regulate the flow of goods, services, money, and workers among them, with a view to creating a common market without frontiers. In that common market, therefore, the member states would relinquish the usual instruments of trade policy, relying upon the institutions of the Community to ensure that the market remained open and competitive. On any definition of trade policy and competition policy, therefore, the so-called *acquis communautaire* covered both.

By observing the Union's behavior in the succeeding decades, the rest of the world may be able to draw some lessons on the relationships between competition policy and trade policy in the handling of problems that arise when goods or services cross national borders. In particular, one can gain impressions of the substitutability of competition policy for trade policy and can identify problems in the maintenance of competitive markets that do not fit comfortably in either the competition policy or trade policy category.

What a study such as this cannot provide, of course, is an evaluation of the relative efficacy of competition policy as a substitute for trade policy. The general case for substituting competition policy for trade policy rests heavily on the assumption that the actions of any trading area based on competition policy are less likely to be vulnerable to special interests and more likely to reflect the area's overall interests. In practice, the execution of trade policy depends heavily on restrictions imposed at the border, such as import and export duties and licenses, whereas competition policy usually relies on measures that proscribe offending practices or reduce the threat of dominance by large firms. As the EU experience confirms, both can be shaped with an eye to the well-being of the producers in the area, but competition policy is less likely to prescribe measures that discriminate against foreign suppliers and that burden consumers.

There is nothing in EU experience to suggest that the assumptions regarding the relative merits of these two lines of policy are invalid. On the other hand, many of the competition policy measures taken by EU institutions—including the Commission, the Council, and the Court—have often evoked sharp criticism, and in some cases it seems, deservedly so. We have not regarded the Union's experience, therefore, as if it were an ideal case of the possibilities of competition policy. Instead, we have sought to use it to identify institutional problems and policy issues that are likely to arise when a government enlarges the role of competition policy at the expense of trade policy.

Analysis of the relative roles of these policies, however, depends to some extent on how one defines the terms. How are we to classify measures taken against predatory dumping by foreign firms that are aimed at destroying domestic firms? Or measures by governments that encourage mergers in order to strengthen exports? As it turns out, one encounters a gray area of policy in which either label will do, according to one's tastes.[2] Our approach is to be clear about the nature of the measures under discussion without identifying them as either competition policy or trade policy when such classification appears arbitrary.

The experiences of the Union in reducing barriers to cross-border movements of services have proved particularly useful in demonstrating the arbitrary character of such definitions. Unlike trade in goods, governments usually apply their restrictions on the sale of services of foreign origin inside their territories rather than at their borders. There are some cases in which border controls will be relevant, as when foreign truckers are required to pay a border tax. But in other cases, as in the practice of medicine or banking, border controls are not involved. Achieving a common market in services, therefore, has presented a more complex challenge than in goods. And there have been enough differences in approach so that, in the pages that follow, we distinguish trade in merchandise from trade in services without always categorizing the relevant policies as competition or trade.

At the Creation

The Background

Both political and economic objectives drove the six EC charter members in 1957 to create a European common market. The paramount political objective was the desire of France and Germany to intertwine their economies so that hostilities between them in the future would be unthinkable. A second political objective, often visible in the motivations of the governments of France, was to pool the economic power of Europe in an effort to increase its political and economic weight in international affairs. But European leaders also had their eye on the added economic advantages that might accrue from increased scale and scope as well as from increased opportunities for their exports.[3]

The provisions of the Rome treaty that emerged out of the negotiations of the 1950s were obviously deeply conditioned by the historical experiences of the signatory countries. One experience that all had shared in the decades preceding was an extensive exposure to cartels and trade restrictions.

Although the period before World War I in Europe is usually described as one of low trade barriers and easy interchanges of goods and services, that sweeping generalization overlooks some salient facts (see,

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2. For an ambitious effort to create a precise delineation between the two fields, see OECD (1993).

3. France placed particular emphasis on the possibility of expanding its markets for agriculture, an emphasis that continues to the present day (Lynch 1993, 59-87).

e.g., Milward and Saul 1977, 468-69). By 1914, interchanges of manufactured goods among the industrial leaders of Europe, including France, Germany, the Low Countries, and Britain, were subject to pervasive cartel restrictions aimed at restraining the movement of manufactured goods between major national markets.[4] Sometimes, especially in chemical products, these cartel agreements were reinforced by an exchange of patent rights. But at other times, as in the case of the International Steel Cartel, the firms involved simply established their market divisions by private contract, including provisions for quotas and fines.

Between the two great wars, the official restrictions of governments, taking the form of tariffs, quotas, and licenses, supplemented the cartels to create formidable obstacles to trade among the European states. But after World War II, a number of factors served to reduce the levels of both private and official restrictions.

One such factor was the European Recovery Program. Under that program, with the financial support of the United States and the institutional support of the Organization for European Economic Cooperation, the countries of Western Europe sought to close the manifest gap in productivity and technological achievement between European industry and US industry (Maier 1987, 121-52). On the trade policy front, those countries launched a series of programs aimed at reducing trade barriers among them, while discriminating collectively against goods and services from outsiders, including the United States. In the field of competition policy, each of the countries participating in the European Recovery Program undertook in bilateral agreements with the United States to prevent restrictive business practices harmful to the achievement of the program's objectives.

Experience under the program suggested a generalization that would be affirmed and reaffirmed in subsequent decades. Trade agreements designed to dismantle restrictions on goods imposed at national borders require comparatively little international apparatus for their implementation. Agreements to restrain the use of restrictive business practices or the abuse of dominant positions by enterprises, on the other hand, depend heavily on the presence of an effective implementing apparatus. Where restrictive business practices are concerned, the facts tend to be elusive and complex, so that complaints are not as readily forthcoming nor as readily pursued. Without an effective apparatus for enforcement in the European Recovery Program, therefore, the commitments regarding restrictive business practices by enterprises proved to be practically a dead letter.

4. Svennilson (1983, 17) remarks on the limited volume of such trade. Hexner (1946, 43-56) documents the principal cartels. Another study reports 114 international cartels before 1914, covering industries in coal, steel, metals, chemicals, textiles, pulp and paper, and various other industries; see Hallinan (1928, 18-19).

Another reason competition policy proved much less important than trade policy in this early period, however, was that the cartels of the prewar period were slow to reestablish themselves in the decade or two after the war. In the first postwar decade, widespread scarcities in Europe reduced the incentives for enterprises to develop private restrictive agreements. Soon after, the presence of US-owned subsidiaries in large numbers in Europe presented an added obstacle.

After the adoption of the European Recovery Program, the next major opportunity for defining the relative roles of trade policy and competition policy arose with the negotiation of the European Coal and Steel Community (ECSC) in the early 1950s (Diebold 1959, 8-20). At the time, coal and steel were perceived as providing the sinews of war, hence as central in intertwining the German and French economies. On the face of it, creating a common market in these industries would be a daunting task, given their history and their structures. Apart from the fact that the International Steel Cartel had been one of the most powerful of prewar Europe, the postwar facilities commonly involved state financing and state ownership (Lister 1960, 84-88, 123-76). Coal pits, too, were in state hands in several countries, and the price of coal was heavily subsidized in Germany. On the other hand, political decisions were still being taken in a spirit of crisis during the early 1950s, and the usual interest groups were exercising less than their accustomed authority. Undaunted, the drafters of the ECSC treaty set out to overcome the national borders among the six member countries for the production and sale of coal and steel.

The motives of the treaty's guiding genius, Jean Monnet, were economic as well as political. Coming away from five difficult years as the head of France's Commissariat du Plan, Monnet was eager to expose the French coal and steel industries to new stimuli that might increase their efficiency. Accordingly, Monnet rejected early drafts of the treaty that seemed to ape the structure of the prewar International Steel Cartel, including geographical divisions of the market along national lines and production and price-fixing by the producing firms. Instead, two seemingly divergent concepts fought their way into the treaty's text, both ostensibly aimed at increasing efficiency: The treaty creates a strong central authority, with powers that could be used for maintaining a highly planned and regulated market among the member countries. But the treaty also contains strong provisions against restrictive business practices and monopolies.[5]

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5. The intellectual roots of the provisions against restrictive business practices and monopolies go back to provisions adopted as a chapter in the Charter for an International Trade Organization. Compare Article 34 of the proposed ITO Charter with Articles 65 and 66 of the ECSC Treaty, for which see US Department of State (1951). See also Diebold (1952, 26-27).

Within a few years of the adoption of the ECSC, its six member countries were negotiating the terms of the much more ambitious and comprehensive European Economic Community (EEC).[6] In the course of that negotiation, the idea of a strong central authority was diluted a little, the victim of a German distaste for dirigiste governmental powers and a French distaste for overt challenges to its national sovereignty. Although the powers of EC institutions remained formidable, the dominant authority rested in a Council of Ministers, composed of representatives of the member states, rather than in an independent High Authority. But the basic idea of a common market survived, constituting the core of the treaty.

Trade and Competition Provisions

The bedrock agreement embodied in the Treaty of Rome was the abolition of tariffs among the member states pursuant to a timetable and the creation of a common external tariff. The formula by which the rates for the common external tariff were established reflected the spirit of the drafters—a joint desire to suspend the usual industry-by-industry haggling over levels of protection in favor of a sweeping approach to the completion of the common market structure. Except for some 70 especially sensitive items, the six member countries agreed to determine the common external rate for each tariff category simply by taking the arithmetic average of the rates in that category previously applied by France, Germany, Italy, and the Benelux customs union.

Among the factors that distinguished the Community from that of any other customs union in history was its adoption of the proposition that private agreements should not be allowed to impede the easy movement of goods and services across national borders inside the market, an objective embodied in a remarkable set of provisions aimed at controlling cartels and dominant enterprises (see, e.g., Rosenthal 1990, 293-343). The Community was charged also with addressing "all measures having equivalent effect" to tariffs and quotas, an open-ended responsibility that would prove important in its subsequent activities. Moreover, it secured some powers to place a lid on measures by which national governments provided financial aid to enterprises on their territories. But how these powers were actually to be implemented was left for future development.

From the first, the organizers recognized that a common market in agriculture would differ drastically from the regime that would apply in other products. With France in the lead and Germany not far behind,

6. Treaty establishing the European Economic Community, 25 March 1957, 298 UNTS 3, often referred to as the Rome treaty.

the treaty reflected the members' view that agriculture should be highly protected from outside competition, even if this required extensive intervention by the Community. Subsequent EC agricultural policies followed lines fully consistent with these early hints.

The treaty's provisions with respect to services, however, were to prove especially revolutionary. The provisions themselves were very general, simply authorizing and directing the Community to see to the free movement of services within the common market (Articles 59 and 60 of the Rome treaty). Effective action under that provision was slow to materialize. But after the enactment of the Single European Act in 1985, it took on major importance.

Institutional Arrangements

Apart from the path-breaking content of the substantive provisions of the Rome treaty, an equally unusual feature was the administrative apparatus adopted for their implementation and enforcement. The Commission of the European Union (the current name of the organization that inherited the responsibility for the execution of the Rome treaty) is the executive arm of the organization, composed today of 20 members nominated by governments for four-year terms, all of them committed to act "with complete independence" and sworn neither to seek nor to accept instructions from any government.

As provided for in the treaty, the Commission is the only institution authorized to initiate proposals for a regulation, a directive, or a recommendation of the Union, but such proposals, as a general rule, cannot enter into force without enactment by the Council of Ministers, composed of ministers of the member governments. However, in the application of the rules relating to the competitive practices of enterprises, addressed under Articles 85 and 86 of the treaty, the Council has delegated its powers to the Commission. And in the handling of individual cases of state aids under Article 92, the treaty itself names the Commission as the executing authority, subject to an override by a unanimous vote of the Council. In all these areas, of course, the Commission's actions are subject to an appeal to the Union's Court of Justice.

Clearly, the Union comprises an unusually powerful set of institutions, with authority and competency not often found above the nation-state level. Functionaries from the constituent member states, it is true, have played a critical role in the Union's decision making. Indeed, the various permanent representatives of the member states residing in Brussels have created an elaborate structure of committees and subcommittees staffed by national civil servants (collectively known as the COREPER) who advise the Commission and the Council of Ministers on a continuous basis.

Yet the outcomes from the Union process have been quite different from those that would have been achieved by a string of international agreements negotiated by the national representatives of those same states. The differences have been due to various factors, including the fact that the Commission has extensive powers of initiation, that EU bodies do not ordinarily require unanimous votes in order to reach decisions, and that the ultimate authority of the European Court of Justice in interpreting its treaties and enactments has so far not been directly challenged. Taken in combination, these features have created an institution that, in addition to enjoying supranational attributes, is heavily insulated from the subnational grass-roots influences to which the constituent national governments of Europe are ordinarily exposed.

There have been times, to be sure, when the Union's supranational attributes seemed under siege. When in the 1960s, the sovereignty implications of the treaty began to be apparent, France's President Charles de Gaulle sought belatedly to curtail the Union's autonomous powers. He demanded and secured a commitment that whenever any member state claimed that its vital national interests were involved in a decision, the provisions for majority voting in the Council of Ministers should be suspended in favor of a requirement for unanimity. And the unanimity rule prevailed until the adoption of the Single European Act in 1985.

Despite that fact, however, EU institutions continued to gain in strength during the decade or two following the 1966 agreement, largely as a result of a series of decisions by its Court of Justice. These decisions embodied a set of principles that clarified and strengthened the Union's jurisdictional reach.[7]

One such proposition formulated by the Court has been the doctrine of direct effect.[8] According to the Court, the unambiguous responsibilities of the Union under the Rome treaty, such as the progressive abolition of customs duties among its members, the creation of a common external tariff, and other measures necessary for the completion of the common market, require no further action by the member states for their validation; they represent legal obligations between member states and their own nationals and even among individuals, obligations that are enforceable in national courts as well as in the judicial system of the Union itself.

A second proposition developed by the Court serves to strengthen the impact of the direct effects doctrine. Any norm that the Union develops within the area of its jurisdiction, whether by EU law or by

7. The key role of the Court of Justice, having been belatedly discovered by political scientists in the 1980s, has generated a spate of theorizing on causes and consequences. See, for instance, Burley and Mattli (1993, 41-76).

8. This section draws heavily on Weiler (1991, 2403-83). See also Hartley (1981, 185-223).

regulation, enjoys the attribute of supremacy—that is, it supersedes any conflicting national law. Accordingly, the Union has the extraordinary power through its directives of commanding member states to change their laws or adopt new laws in order to conform with Union law. And, even if a country fails to do so, its nationals are entitled to appeal to EU directives as a basis for determining their rights before their own national governments (*Italy v. EC Commission*, Case 41/83, [1985] ECR 873).

In another line of decisions, the Court has strengthened the Union by recognizing some implied powers—powers not explicitly granted in the treaty but recognized by the Court as essential for the achievement of the treaty's purposes. One of these is the Union's right to enter into international agreements in the areas of its competence, agreements binding not only on the Union but on member governments as well. In some of these areas, the Union's power to enter into international agreements is seen as exclusive, precluding agreements of any kind by the member states. In others, the Union is seen as sharing jurisdiction with the member states. But if the Union legislates in these areas of shared jurisdiction, such action may have a preemptive effect, creating a barrier against independent action by the member states.

When we observe the actions of the Union, then, what we are observing are not the actions of national governments as constrained by international agreement but the measures taken by a supranational institution with some of the attributes of sovereignty in a defined area of competence.[9] True, numerous questions have been raised regarding the Union's legitimacy, given the extraordinary powers it purports to exercise (Weiler 1992, 1-16). Such questions became particularly insistent after 1992, with the adoption of the Treaty of European Union (the Maastricht treaty), which extends the mandate of the Union into areas heretofore largely reserved to the member governments. These include the creation of a common European currency and a European Central Bank, along with some carefully circumscribed measures for the coordination of foreign policy and the support of pan-European communication and transport networks.[10] But no serious sentiment has existed in Europe for the dismantling or even the substantial reversal of the giant strides already taken toward the creation of an economic union.

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9. Not all observers agree with such a view. See, for instance, Hoffmann (1982).

10. The "democratic deficit" of the Community has been widely discussed in various sources, reflecting the fact that the only body of the Community whose members are directly elected to their Community positions is the European Parliament, a body whose powers are largely consultative in nature (Hartley 1981, 18). The Treaty of European Union, adopted in 1993, and the Treaty of Antwerp, negotiated in 1997, augment those powers, but not to the extent usually associated with a parliament.

Trade Policies

Dominance of the Common Market Goal

From the Union's birth in 1958 to the enactment of the Single European Act in 1986, the objective of creating a common market among its members shaped and dominated EU trade policies, affecting the members' trade relationships with nonmember countries as well as with each other. As we observed earlier, a driving goal of the Community's founders was to so intertwine the economies of France and Germany as to render economic independence an impossibility for either. As long as that goal determined the policymakers' actions, relations with other countries were bound to take second place. That outcome, however, might not have prevailed if the Union's institutions had not been endowed with their extraordinary powers.

On matters of trade with the outside world, the treaty placed the lawmaking function of the Union squarely in the hands of its Commission and its Council of Ministers and, with an assist from the EU Court of Justice, reduced the powers of national governments to "cases of emergency." The covenants that bind member countries in the development of a common market, therefore, are far more powerful than any other agreements they can enter into, whether with each other or with outside countries. In disputes among EU members, for instance, a country cannot invoke the provisions of other international agreements, such as the General Agreement on Tariffs and Trade (GATT), if those provisions are inconsistent with the Rome treaty, nor can it turn to Union institutions in an effort to enforce such provisions; neither can a member state appeal to such outside commitments as grounds for failing to fulfill its obligations under the Rome treaty.[11]

In the exercise of its trade powers, therefore, the Union has developed a structure of trade relations that builds outward from a European core. The core, of course, consists of the trade among the members; as membership grew from the original 6 to 15 countries, intra-Community trade gained in importance. Whereas trade among members amounted to only 44 percent of the total trade in 1960, it represented 68 percent of the members' total trade in 1995. Layers outside the core are made up of a variety of preferential relationships, involving scores of nonmember states. That element of EU foreign trade, representing about 30 percent of the total in 1960, has declined to about 18 percent since then.[12] Fur-

11. For an analysis of the relationship between obligations under the Rome treaty and obligations under the GATT, see Tumlir (1986, 1-22), Petersmann, (1981, 23-72), and Maresceau (1981, 107-26).

12. Preferential trade arrangements include agreements with the African, Caribbean, and Pacific (ACP) countries; various Mediterranean countries; countries in Eastern Europe;

ther out from the core lie those members of the GATT not included in the preferential arrangements of the Union—the United States and Japan, among others, as well as a few states in remote outer darkness toward which the Union has no trade commitments. Trade with these groups, which amounted to about 26 percent of total Union trade in 1960, stood at about 13 percent in 1995.[13]

The Common Market Core

By the terms of the Rome treaty, member states were obliged to eliminate customs duties and quantitative restrictions in trade between them through a step-by-step process that was effectively completed by 1968. During the same period, the common external tariff provided for in the treaty was gradually being put in place.

The principle that trade restrictions inside the common market were to be abolished in effect barred member states from using their usual trade policy tools in that domain. After a period of transition, antidumping actions between member countries were abolished, along with national measures that had been applied to offset the state aids of other member countries. And the responsibility for initiating dumping and state-aid measures against nonmember countries was shifted from the individual member states to the Community (Green, Hartley, and Usher 1991, 14-19).

In assuming its responsibilities, the Community inevitably had to deal with a variety of problems, some relating to the special circumstances of an individual industry, some to difficulties facing a single member. In dealing with those problems, the Community began to exhibit a characteristic that would typify its behavior in the decades to follow—a tendency to improvise. EC institutions, particularly the Council of Ministers, exhibited a suppleness in individual cases that seemed more akin to the negotiation and renegotiation of a contract among its member states than the application of a treaty provision.

This flexibility in implementing the common market has in fact been so pronounced at times as to raise doubts in some eyes as to the achievement of the underlying concept. From the beginning, the Rome treaty has included a provision, Article 115, under which the Commission could authorize individual member states to impose "protective measures" against imports from nonmembers, where such action was needed

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and the approximately 130 countries that fall under the Community's Generalized System of Preferences (GSP).

13. Data are based on various annual issues of GATT, *International Trade*, Geneva and IMF, *Direction of Trade Statistics Yearbook,* Washington.

to avoid "economic difficulties."[14] With the Commission's assent, member states have made extensive use of Article 115, especially in protecting their automobile, textile, and consumer electronic industries, and in favoring selected foreign sources of bananas in their home markets. But to implement such restrictions, member states have been permitted to maintain so-called surveillance arrangements within the common market aimed at preventing the frustration of their restrictions. By 1985, 1,800 surveillance measures were in place inside the common market, and in several scores of cases, actual import restrictions were being imposed (Henrichs-Cohen 1993, 564).

The threat that such measures posed to the common market concept was, of course, widely recognized. And in the years following the adoption of the Single European Act in 1986, the Commission would succeed in reducing considerably the use of these individual-country measures.

Efforts were made to remove the provisions of Article 115 completely in the sweeping treaty revisions adopted in 1993, but these efforts failed. Instead, the Union sought to "communitarize" the remaining restrictions by folding them into Community-wide schemes that took account of the special demands of individual countries; country-specific restrictions on foreign automobiles and bananas, for instance, were incorporated in such schemes.

A Layer of Preferences

In accordance with the treaty's provisions, the Commission conducts trade negotiations, pursuant to Council directives and with the advice of a special committee composed of national representatives, the so-called 113 Committee, which has performed as a Council of Ministers in miniature.

In the decades prior to the adoption of the Single European Act, as we observed earlier, the European Community found itself developing preferential arrangements with third countries. There were free trade agreements with other European countries—members of the European Free Trade Area—covering nonagricultural goods. There were bilateral agreements with countries in the Mediterranean Basin, the Middle East, and eastern Europe, giving them preferential access to EC markets over a specified range of products. There was an oft-renewed agreement with several dozen former colonies in Africa, the Caribbean, and the Pacific, giving them even wider preferential access to EC markets. And there was a system of lesser preferences for several scores of other developing countries.

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14. For a careful review, see Henrichs-Cohen (1993, 553-587). For an analysis of these measures, see Bronckers (1983, 53) and Henri Froment-Meurice (1988, 65-117).

In formulating these preferential relationships, however, the Community typically retained all the usual tools of trade policy, such as antidumping duties and emergency import restrictions. Cases were common, therefore, in which exporters to the common market encountered such obstacles despite their preferential status.

The World Beyond

Trade relations with the world beyond these preferential areas have been governed largely by the GATT, as well as by agreements covering selected services, such as banking, telecommunications, and air travel. Despite the GATT's lack of standing in matters that involve relations between EU members, the Union readily acknowledges the GATT's imposition of obligations on the Union as a whole. And the Union has played an active role in trade negotiations under the aegis of the GATT.

Yet the Union's status in the GATT has been utterly anomalous. All the member countries of the Union are also GATT signatories, but the Union itself is not. Nevertheless, the non-Union signatories of the GATT look to the Union, as they must, to carry out the obligations of its member countries.

Although the Union generally has provided for nondiscriminatory treatment of goods at its borders, it has exercised its propensity for ad hoc solutions with particular freedom in matters relating to its GATT obligations. True, all GATT members have tended toward ad hoc solutions of their disputes; this is because GATT provisions encourage countries to settle them bilaterally before invoking its dispute settlement machinery. But the Union's preferential agreements have been tailored to each country, without much regard for the standards contained in the GATT.

This ad hoc approach has been especially pronounced in EC application of antidumping duties. From 1970 to 1974, the Commission initiated only two or three cases a year alleging dumping by outside countries into EC markets. Between 1976 and 1980, however, the number had risen to about 25 a year; from 1980 to 1984, it had increased to over 40 (Commission of the European Union 1993). In the years following the adoption of the Single European Act, from 1986 to 1995, the number of new cases per year leveled off; but as of midyear 1995, the number of EU antidumping measures in force stood at 178 (Trade Policy Review Body 1996).

Moreover, with the increase in antidumping cases, the Community's use of the antidumping concept seemed to grow increasingly creative (McDermott 1988, 315-30; Steele 1996). One development of considerable importance was the Community's increasing tendency to accept "price undertakings" from foreign exporters as a basis for settling investigations of alleged dumping. By the 1980s, price commitments were being used twice as frequently as antidumping duties as a basis for closing antidumping cases.[15] Moreover, the Court of Justice was routinely affirming such decisions in cases of appeal, assessing the appeal costs on the appellant defendants in such cases (Van Bael and Bellis 1990, 220).

The Community's expanded use of antidumping provisions produced its inevitable aftermath: a game of cat-and-mouse between multinational enterprises and the regulatory authorities. Some firms set up subsidiaries inside the common market with the ostensible purpose of importing components at prices above those required by existing antidumping measures, assembling them inside the Community, then selling the assembled products at unacceptably low prices. The Community countered with its well-known "screwdriver plant" regulation, subjecting the output of such European plants to the same antidumping treatment as that accorded to imports.[16] Quite clearly, the Community chose to regard the output of such plants as if they posed a trade problem rather than a competition problem, notwithstanding that the plants themselves lay inside the common market.

Another device that multinational enterprises used to deal with EC antidumping efforts was to shift their sourcing of the targeted imports from the foreign facility charged with dumping to another controlled source. That tactic elicited another blocking response, embodying still another use of a trade policy instrument in the form of an "anti-circumvention tax" imposed on the products from the substituted source.[17] Eventually, a GATT complaints panel would find such measures in violation of the agreement, but the problem did not subsequently go away (GATT 1990).

All told, the history of the EC application of trade policy points to two lessons. One is the dominance of the common market objective over the global commitments relating to trade policy, epitomized in the GATT: When conflicts occur, the common market objectives of the Union usually take precedence. At the same time, there are signs that the increasing importance of multinational enterprises in the world economy

15. From *Annual Reports of the Commission on the Community's Anti-dumping and Anti-subsidy Activities*, various years. The series begins in 1983 (Commission of the European Communities 1983).

16. Council Regulation (EEC) No. 2423/88, *Official Journal of the European Communities* (hereafter *OJ*) 1988, L209/2. The regulation applies to assembled products made up of components subject to antidumping procedures, provided such components constitute 60 percent or more of the value of the assembled product. The regulation has been applied to plants in the Community assembling typing machines and photocopy machines.

17. For a discussion of the implications and legality of EC regulation No. 2324/88 establishing the anticircumvention tax, see Torremans (1993, 288-30) and GATT (1991, 1075).

offers a growing challenge to the efficacy of Europe's trade policy measures, as such enterprises seek effective entry into the huge European market.

Competition Policy: Restrictive Business Practices

Inside the common market, competition policy has been a powerful weapon. And one obvious application of such policy has been in the field of restrictive business practices.

The Provisions

The Charter for an International Trade Organization, negotiated in 1947, contained an elaborate set of provisions for dealing with such practices. Although the charter failed to materialize, its influence was reflected in the content of the Rome treaty on restrictive business practices. But the more immediate forerunner of the relevant sections in the Rome treaty consisted of similar articles in the treaty creating the ECSC.

The spirit that drove these provisions in both treaties, however, was not a simple commitment to competition. The prewar cartels, it will be remembered, had usually divided up markets along national lines. The provisions in these treaties, therefore, included a political determination that the national barriers lifted by the elimination of governmental trade restrictions would not be thwarted by private restrictions.

Article 85 of the Rome treaty lays down a draconian prohibition against agreements and concerted practices among enterprises that may prevent, restrict, or distort competition in the common market, including the fixing of prices; the control of production, procurement, marketing, investment, and innovation; and the discriminatory treatment of sellers. Agreements or decisions prohibited by the provision are automatically void, so that they cannot be invoked or enforced by any of the parties anywhere in the common market.

Up to that point, one can detect the shades of US antitrust statutes; but then Article 85 takes a distinctly European turn, endowing the Commission with broad powers to exempt any agreement, decision, or practice, singly or by category, that satisfies specified criteria. An exemption may be earned if the agreement satisfies four conditions:

- It must contribute to improving the production or distribution of goods or to promoting technical or economic progress.
- It must allow consumers a fair share of the resulting benefits.
- It must not impose restrictions superfluous to the achievement of these objectives.

- It must not afford the possibility of eliminating competition "in respect of a substantial part of the product in question."

Cynics wondered at the time these Janus-like provisions were adopted if any substance remained, but subsequent events demonstrated that the provisions have considerable substantive importance.

Because Article 85(1) rendered null and void any agreement that fell under its prohibitions and because the treaty's provisions dominated national legislation to the contrary, the Community was under great pressure to settle a number of issues as rapidly as possible: how to define the outer limits of the prohibitions in order to take account of the special positions of various sectors under the treaty, including agriculture, transport, defense, public monopolies, and the like; how to integrate EC action with the action of national governments under their respective antitrust statutes; and how to formulate and issue exemptions from Article 85(1).

By 1962, the Council of Ministers had adopted a key regulation laying out a process by which the Commission could administer these provisions.[18] The regulation provided that any enterprise that concluded agreements containing any of the proscribed provisions of Article 85(1) could report those agreements to the Commission, requesting an exemption from the prohibition, with the understanding that any exemptions granted would ordinarily be retroactive to the date of notification. Failing notification, firms faced the risk of heavy penalties in the event their agreements were later found in violation of Article 85. Another part of the regulation set out a procedure by which an enterprise could obtain a "negative clearance" from the Commission; that is, an acknowledgment that a specified agreement lay outside the scope of the prohibitions in Articles 85(1) and 86.

Agreements among Competitors

Not surprisingly, the reporting requirements turned up very few cases of simple market-sharing arrangements among potential competitors fashioned on the cartels of the prewar period. But eventually a number of such cases did surface, providing a platform on which the Commission and the Court could interpret and apply Article 85.[19] A series of

18. Regulation 17 of the Council of 6 February 1962 implementing Articles 85 and 86 of the treaty, *OJ* (1962) 13/204; amended *OJ* 1962, 58/1655, *OJ* 1963, 162/2696, and *OJ* 1971, L285/49.

19. See *Aluminum Imports from Eastern Europe*, *OJ* 1985, L92/37; *Woodpulp*, *OJ* 1985, L85/1; *Rio Tinto Zinc Corporation & Others v. EC Commission*, Joined Cases 8, 50, 54-56, 111, 113 & 117/73, [1975] *European Court Reports* (hereinafter ECR), p. 1663; *ICI v. EC Commission*, Cases 48-57/69, [1972] ECR 619; and *International Quinine Agreement*, *OJ* 1969, L192/5.

such decisions reaffirmed the fact that the Union was prepared to move energetically against arrangements that had the explicit effect of carving up markets among potential competitors within the Union. Nor was the Commission tolerant of blatant efforts among competitors at fixing prices, limiting production, or restricting technological change when these had a distorting or restraining effect on trade within the common market and could not be justified by the standards for granting exceptions under Article 85. Even when such agreements were ostensibly contained within a single member country, the Commission felt free to condemn them if they demonstrably affected the trade of that member country with other countries in the Union.[20] And eventually, following a doctrine adopted much earlier by the United States, the Court also asserted its jurisdiction over agreements entered into outside the Union that had effects on the Union's markets.[21]

The exemption criteria of Article 85, however, proved sufficient in the eyes of the Commission and the Court to allow for some restrictive agreements among competitors. After some soul-searching, the Commission cautiously acknowledged that it might be prepared to allow some agreements designed to reduce excess capacity in a given industry. Eventually, in a number of decisions that were widely interpreted as bending to the pressures of special interests, it granted several such exemptions.[22] The Commission also allowed some "no-future-competition" commitments to stand that the parties had entered into in connection with the takeover of firms, although it insisted that the terms of such restrictive clauses should not be so extensive as to outweigh the gains generated by the takeover.

Vertical Agreements

Although the reporting requirements adopted by the Council of Ministers in 1962 produced few cases of old-fashioned cartels among potential competitors, it provoked a deluge of reports of agreements between producers and their distributors, between licensers and licensees, and between principals and agents of various sorts. Collectively, these reports revealed a network of business arrangements that appeared prima

20. See *Vereniging van Cementhandelaren v. EC Commission*, Case 8/72, [1972] ECR 977 and *Groupement des Fabricants de Papiers Peints de Belgique & Ors v. EC Commission*, Case 73/74, [1975] ECR 1491.

21. Re the "Woodpulp Cartel" (1988) 4 *Common Market Law Reporter* (hereinafter C.M.L.R.) 901: *A. Ahlstrom Oy and Others v. EC Commission*, Joined Cases 89/85, 104/85, 114/85, 116-117/85, and 125-129/85.

22. See Commission of the European Communities 1982, 43-45). See also *Synthetic Fibres Agreement*, *OJ* 1984, L207/17.

facie to be creating numerous barriers between national markets inside the Union. The greatest number of these consisted of bilateral agreements between suppliers and their distributors, designed to grant the distributor a monopoly over the supplier's product inside a given national market and to grant the supplier the assurance that the distributor would not handle rival products in that market.

Thereafter, the administration of competition policy became a major preoccupation of the Commission. Well over 100 professional administrators were involved in the process (apart from the ubiquitous translators required in the operation of the Union's institutions), and a considerable part of the docket of the Court of Justice consisted of cases under review (Van Bael and Bellis 1990).

The problem of maintaining a common market against the challenge of restrictive business practices forced the Union to confront still another major issue that trade policy specialists had commonly overlooked. The agreements that flooded the Union's offices in Brussels typically appeared to consist of nothing more than an arrangement between a principal in one country and an agent in another, without any attributes of independence residing in the agent. The agent, for instance, might even be a wholly owned subsidiary of the principal.

From a trade policy viewpoint, the fact that the agent's transactions might represent no more than a transfer within a single organization constitutes no basis for waiving the usual measures by which dumping is measured. Trades between a parent and a wholly owned subsidiary, therefore, are exposed to all the tests that would apply if they were trades between independent parties. But, as the Union soon learned, any serious application of competition policy requires the administering public agency to recognize when a single party is both buyer and seller in an observed transaction. Eventually, therefore, the Commission and the Court came to recognize the possibility that a "group economic unit" might be responsible for a given pattern of international trade, and with that recognition, these institutions set the stage for some of the critical judgments that were required in the application of competition policy (Goyder 1988, 79-83).

Developing Policy

Predictably, the task of sorting out private agreements under the Rome treaty criteria proved overwhelming. The exemptive standards laid out in Article 85 of the treaty seemed at first to require a study of each individual agreement in order to determine if it met the requirements for exemption. Besides, many of the agreements between suppliers and their distributors that seemed to create divisions between national markets were fortified by licenses to patents, trademarks, or unpatented technology. With Article 36 of the treaty exempting restrictions by member states imposed for the protection of "industrial and commercial property," the risk existed that otherwise unexceptionable private arrangements might be parceling out national markets, thereby imperiling the common market concept. But in the end, a series of decisions by the Commission and the Court substantially reduced that risk.

It is beyond the scope of this report to review all the subtle distinctions and nuances that the Commission developed in the course of its administration of the "negative clearance" procedures and the exemptive provisions of Articles 85 and 86. But as the Commission gained experience, certain propositions began to emerge as characteristic features of its decisions. The Commission, for instance, was prepared to accept the desirability of producers marketing through a network of distributors, if the distributor could be assured of its position as the sole designated agent in a given territory, and the producer could be assured that the distributor would not take on rival products. But such arrangements were more easily tolerated if the products had complex marketing requirements and if other producers were in the market, as in the case of automobiles. Moreover, the Commission was especially allergic to restrictive provisions that could be applied after the appointed distributors had sold their products in the market; even where patents existed covering such products, the Commission limited their use as a means of blocking cross-border transactions inside the common market.[23]

In the course of time, the Commission gained enough confidence in its ability to distinguish desirable from undesirable agreements that it began issuing group exemptions covering specified types of provisions. Between 1967 and 1985, eight such exemptions were issued, covering exclusive purchase and distribution agreements, specialization agreements, research and development agreements, and patent license agreements. The terms of these group exemptions offer a snapshot of EC policy under Article 85.

One of the most elaborate of the group exemptions, covering joint research and development agreements, was issued in 1984 following a long struggle.[24] At issue was the familiar problem of finding the right balance between the conditions for encouraging research and development and the conditions for preventing collusion or monopoly. To limit the possibility of abuse, the exemption was hedged in numerous ways to ensure that such an agreement would not be converted into a market-sharing arrangement. One such provision terminated the exemption itself five years after the first marketing of a product that issued

23. See *Consten & Grundig v. EC Commission*, Joined Cases 56 & 58/64, (1966) ECR 299; *Davidson Rubber Company*, *OJ* 1972, L143/31; *Burroughs-Delplanque* CMLR D67, (1972). For a discussion, see Goyder (1988, 258-62).

24. Regulation No. 418/85 on the application of EEC Treaty Article 85(3) to research and development agreements, *OJ* 1985, L53/5.

from the research program, or when the market share of the parties to the agreement reached 20 percent. Within these constraints, various restrictive measures are explicitly permitted, such as an undertaking by the parties not to enter into research and development agreements with third parties in the field covered by the agreement, and even an assignment of exclusive territories among the parties during the five-year marketing period. But there is also an extensive blacklist defining practices that are not permitted by the exemption, such as agreed restrictions on quantity and price, as well as undertakings not to challenge the validity of patents issuing from the research program inside the common market.

Competition Policy: Monopoly and Dominance

From the first, the drafters of the Rome treaty had been aware that overcoming the barriers that separated national markets inside the Community would require much more than the provisions of Article 85 could deliver. One problem they would have to confront, for instance, was the existence of legal monopolies that were created for a variety of social, fiscal, or other purposes and that all member countries maintained—from telephone systems to tobacco monopolies. In this area, it was evident the Community would have to proceed cautiously.

Article 90 of the treaty reflected that caution: such enterprises would be subject to the anticompetitive prohibitions contained in the treaty, but the application of such rules was not to obstruct "the *de jure* or *de facto* fulfillment of the specific tasks entrusted to such enterprises." Predictably, this delphic provision would be the subject of a continuous battle in the decades to follow. It would not be until the enactment of the Single European Act in 1986 that the Commission would attempt to deal effectively with those state monopolies.

In addition to dealing with the problems created by the threatened dominance of legal monopolies, the treaty also addressed the potential dominance of enterprises that were not state supported. Article 86 of the treaty prohibits enterprises from taking improper advantage of a dominant position in the common market to the extent that their actions affect trade between any member states. Such actions include, for instance, imposing "inequitable" purchase and selling prices; placing limits on production, markets, or technical development to the detriment of consumers; discriminating among trading partners to their competitive disadvantage; and attaching supplementary tie-in conditions to contracts.

As in the case of Article 85, Article 86 has given the Union considerable room for interpretation, especially in determining when an enterprise is dominant and when it uses that position abusively. In a series of decisions, the European Court confirmed that various enterprises in fact held dominant positions, including in some instances enterprises that consisted of partnerships among firms in the same line of business.[25] The key characteristic of a dominant enterprise, according to the Court, was the ability to prevent effective competition, a capacity that derived from its power to behave independently of its competitors and customers. The signposts that such a condition existed obviously were not rigid. But where sellers were found to hold a dominant position, they usually were in control of a large share—say, 35 percent—of some defined market.

What the Court determined to be abuses within the meaning of Article 86 covered a wide range. In a few instances, the Court found the existence of abuse under circumstances that would have evoked antidumping duties if trade policies were being applied. There was, however, a critical difference between the Court's application of a remedy in such cases and the application of dumping duties as practiced in the wide world beyond—a difference that epitomizes a fundamental distinction between competition policy and trade policy. In the application of trade policy, the central question is whether "dumping," however defined, has occurred, but in competition policy, the central question is whether the conduct of the offending enterprise, viewed broadly, is deemed injurious to the maintenance of a competitive market (*ECS/AKZO*, *OJ* 1985, L374/1).

Much more common than dumping cases, however, were cases involving anticompetitive practices of other types. Some of these had been dealt with under national laws, but many had been tolerated in the national jurisdictions of member states. One group of cases addressed by the Commission involved the use of so-called "fidelity rebates." As the name implies, these were special rebates available only to customers who committed themselves to buying from a specified list of sellers.[26] Other anticompetitive practices were dealt with as well: withholding supplies from a customer in order to stifle competition, charging different prices to different customers, and charging "excessive" prices, defined as prices that have no reasonable relation to the economic value of the product supplied.[27] Neither the Commission nor the Court, how-

25. *United Brands v. EC Commission*, Case 27/76, (1978) ECR 207, p. 277 (para. 65). The definition of dominance in this case was later applied in *Hoffman-La Roche v. EC Commission* ('Vitatims'), Case 85/76, [1979] ECR 461; *Michelin v. EC Commission*, Case 322/81, [1983] ECR 3461; and *CBEM-Telemarketing S.A. v. Compagnie Luxembourgeoie de Telediffusion (CLT) and Information Publicitie Benelux SA (IFB)*, Case 311/84, [1985] ECR 3261. For a case dealing with a dominant buyer, see "Railway Rolling Stock," in the Commission of the European Communities (1975, 60-61). For a case dealing with a dominant group, see *European Sugar Industry*, *OJ* 1973, L140/17.

26. See *Suiker Unie & Ors OJCooperatieve Vereniging v. EC Commission* (joined cases 40-48, 114/73) 16 December 1975 (1975) ECR 1663.

27. See *United Brands v. EC Commission*, cited above. The case turned in part on whether United Brands was discriminating in response to its own competitive needs or in response to the interests of its favored distributors, the latter being seen as more objectionable.

ever, saw any of these practices as a violation per se of Article 86, each one being adjudged for its effect in the context in which it was practiced.[28]

EC concern with the abuses that could be practiced by dominant firms eventually led it into an area pioneered by US law, namely, the control of mergers among large enterprises. In 1972, the Commission had brought a case against Continental Can, aimed at preventing it from acquiring a rival firm in the Netherlands through a German subsidiary. The Commission's argument was that the acquisition was illegal under Article 86, creating a dominant position in packaging materials in the common market and threatening its competitors (*Continental Can*, *OJ* 1972, L7/25). Although the Court overrode the Commission's decision in the individual case, it nevertheless chose to use the case as an opportunity for approving the use of Article 86 to prevent mergers that would have the effect of stifling competition (*Europemballage and Continental Can v. EC Commission*, Case 6/72, [1973] ECR 215).

With the tie between mergers and anticompetitive practices having been recognized, the Commission sought to gain the right to screen mergers routinely before they were consummated, as some EC countries had the power to do under their national laws. Sixteen years would pass, however, before the Council of Ministers could agree on a regulation empowering the Commission to review prospective mergers, launching a program on which we comment below.[29] During that interval, there were continuous discussions of the relative merits of fostering competition in the Community versus building up "champions" to do battle in world markets, a tension that continues to the present day.

Competition Policy: State Aids

To establish a common market, the members of the European Community were obliged to grapple not only with the market-sharing and predatory propensities of individual enterprises, but also with the widespread lending of financial support by European governments to firms operating in their respective jurisdictions. As long as governments were free to impose restrictions at their borders, they retained the option of imposing countervailing duties against foreign goods that had benefited from such official support. But with the initiation of the common

28. See, for instance, "Gillette Received Brussels Ultimatum," *Financial Times*, 12 November 1992, 18, a case in which Gillette's acquisition of a 70 percent share of the market was seen by the Commission as an abuse of a dominant position.

29. Council Regulation (EEC) No. 4064/89 on the control of concentrations between undertakings, *OJ* 1990, L257/13.

market, member countries had to look to competition policy in order to deal with state aids.

In Europe, government financial support to industry has a rich and extensive history (Shonfield 1965; Wilson 1985). Accordingly, Articles 92 and 94 of the Rome treaty relating to state aids are much more equivocal in their recognition of the virtues of an open, competitive market than Articles 85 and 86. True, Article 92 begins with a broad condemnation of state aids in any form that distort competition and adversely affect trade within the common market. But the article then explicitly defines some categories of state aid as compatible with the common market: aid of a social character that does not discriminate on the basis of the origin of products (such as a subsidy for the purchase of medicines); aid to deal with natural disasters or other such events; and aid to specified areas of Germany to overcome the problems of German partition.

Having narrowed the scope of its prohibitions a little, Article 92 then goes on to define state aid programs that the Commission may in its discretion find compatible with the common market. These cover a very wide range, including programs to elevate depressed regions, programs to execute important projects (such as the Chunnel, the pan-European high-speed train system, and the Airbus family of aircraft), programs to remedy "serious economic disturbances," and programs that the Council of Ministers approves on recommendation of the Commission. To put teeth in these provisions, the treaty prescribes a screening procedure that subjects existing and future state aid programs to the scrutiny and approval of the Commission. Where new programs are involved, the Commission has two months in which to demur, and, in the absence of such action, the member state is entitled to proceed with its state aid program.

Reflecting the spirit of these treaty provisions, the Commission's administration has exhibited much less doctrinal fervor than in the case of Articles 85 and 86. Indeed, the Commission has gone to some pains to describe its administration as "basically realistic" (Commission of the EC 1972, quoted in Goyder 1988, 375-76). That realism has been manifested in various ways, beginning with the Commission's recognition that state aids can take many forms, from outright grants and preferential loans to more subtle infusions of cash in the form of tax exemptions and stock purchases.

More to the point, however, has been the Commission's pragmatism in distinguishing between acceptable state aid programs and those that did not merit approval. One criterion has been that of *selectivity*; accordingly, schemes that provide support for a well-defined geographical region are more acceptable, as a rule, than schemes that are much less specific regarding the areas and industries to be supported. The *transparency* and specificity of the proposed aid provide a second criterion. *Temporary measures* are more acceptable than those of indefinite duration, especially if the measures are designed to tide over the affected enterprises in the handling of a transitory problem rather than to prop up a chronically sick sector. The *appropriateness* of the proposed aid, given the problem it is designed for, provides yet another criterion. And the measure of *benefit or harm* to the Union as a whole provides still another peg for the Commission's final verdict.

However, one has to recognize that the decisions of the Commission in this area are fundamentally pragmatic, taken with a strong sensitivity to the nature of the political pressures that its member states face. This does not mean that the Commission's reviews are altogether perfunctory. During 1981-85, for instance, the Commission reviewed more than 761 state aid schemes. While 77 percent were allowed to pass without objection, the remainder encountered some obstacle in the review process, commonly leading to revisions.[30] After the adoption of the Single European Act in 1986, the Commission visibly tightened its review standards. But the Commission's disposition to avoid confronting any member state with a politically intolerable decision remains evident.[31]

The Single Act and Its Aftermath

The Background

In 1985, the EC states agreed to launch into a new phase in the process of integration, a decision that introduced a decade of frenetic change.[32] Despite the remarkable developments of prior decades, the common market was still very far from being a single economic unit. On the contrary, national frontiers inside the common market continued to offer substantial impediments to the easy movement of goods and services and of the resources required to produce them.

The remaining impediments, although substantial, on the whole had received little attention from economists and policymakers in the past. They took the form of national monopolies such as those in telecommunications and energy distribution, national regulations such as those in the fields of environmental control and consumer safety, national

30. The figures do not include aid to agriculture, fisheries, and transport (Commission of the European Communities 1990, 135, table 2).

31. The Commission's decision to allow Italy to subsidize the closure of 68 steel plants in June 1994 represented an especially striking illustration of the Commission's willingness to bend its own rules. See "Brussels Resurrects Steel Plan," *Financial Times*, 16 June 1994, 1. See also "The Aidbusters' Charter," *Financial Times*, 14 December 1996, 15.

32. There are several other interpretations regarding the factors that produced the Single Act initiative (see, e.g., Sandholtz and Zysman 1989, 92-128; Moravcsik 1991, 651-88; Keohane and Hoffmann 1992, 1-40; Cameron 1992, 23-74).

qualifications for the practice of the professions such as those in engineering and law, and national recognition and enforcement of privately developed product standards such as those in consumer durable goods.

Throughout the 1970s and early 1980s, the Commission had been sponsoring piecemeal efforts to reduce these diverse impediments, largely by attempting to harmonize the relevant national regulations. Now and again, these efforts came to a head in ambitious proposals sponsored by prestigious committees, but until 1985, the results were distressingly meager. As a result, the prices of products and services typically varied substantially from one member country to the next, with differences that could not conceivably be explained by transportation costs (Emerson et al. 1988, 147-50). Thus, in 1985 the dispersion of price for goods and services bought by households, as reflected in national averages, came to about 22 percent of the average prices prevailing in the Community (Emerson et al. 1988, 147, 277). The prices of wine, vegetables, and automobiles displayed much larger differentials, rising to 60 percent in some automobile categories.

What helped bring matters to a head in 1985 were several trends, deeply disturbing to Europe's leaders and that convinced them that the EC economy was headed toward a crisis. One such development was the persistent slippage of Europe in its competitive race against Japan and the United States, a trend already visible in the 1960s (OECD 1970). By the early 1980s, EC sources were observing that of 37 technological sectors "of the future," 31 were dominated by the United States, 9 by Japan, and only 2 by Europe; that 4 out of 5 patent applications for new materials were being filed by US and Japanese companies, and that the leading European company in computers occupied only 10th place in the world computer industry.[33]

To make matters worse, Europe in the 1980s was being challenged from the low end of the technology spectrum as well as from the high end. Countries such as Korea, Taiwan, Brazil, and even India were beginning to compete effectively against Europe in standardized products such as steel, bulk chemicals, small motors, computer software, and the like. From the viewpoint of European industry, Europe's competitive advantages were evaporating. In all, between 1980 and 1986, the EC share of world manufacturing exports fell from 23 percent to 19.5 percent ("A Rude Awakening: A Survey of the European Community," *Economist*, 3 July 1993, 50).

According to conventional wisdom at the time, the remaining impediments in the common market were preventing the firms in any member country from looking on the whole of Europe as a home market. That situation, in turn, was discouraging businesses in Europe from engaging in cross-border mergers, building firm resources to the levels of their

33. For an overview, see Sharp (1993, 200-26).

competitors in Asia and North America and using those resources in the global race to develop new products and to invest in new processes. In response to this diagnosis, the leading firms of Europe plunged into a campaign to accelerate the move toward a single market (Sandholtz and Zysman 1989, 116-18; see also Green-Cowles 1994).

The advances of the single-market concept on the political front during the early 1980s offered the bureaucrats in Brussels the opportunity they had persistently sought. The brilliance with which they exploited that opportunity was due in considerable measure to the leadership of Jacques Delors and Lord Cockfield, who developed a program to implement the political decision that was far more extensive than anyone could reasonably have expected.

The strength of the bureaucrats' response was augmented by the fact that the Court had been so quietly persistent in interpreting the Rome treaty in ways that would support a single-market concept. The idea that national regulations and national professional requirements might violate the Rome treaty by creating an impediment to the common market's realization had appeared in its opinions for a decade or more before the political decision to move toward a single market. As early as 1974, the Court observed that "all trading rules by member states which are capable of hindering, directly or indirectly, actually or potentially intra-Union trade are to be considered as measures having an effect equivalent to quantitative restrictions" (Case 8/74 *Procureur du Roi v. B. & G. Dassonville* [1974]). Eventually, that idea would be applied not only to the movement of goods but also (with some caveats) to the sale of services.[34]

The Brussels bureaucrats, however, chose to pin their proposed program for a single market on a more recent and more widely advertised opinion of the Court, the celebrated *Cassis de Dijon* decision, which obliged Germany to suspend its restrictions on the importation of a French cordial (Case 120/78, *Cassis de Dijon*, [1979] ECR 649). In that case, the Court concluded that although French regulations differed from those of Germany, they were equivalent in effect and hence had to be recognized by Germany as satisfying German objectives. Building on that opinion as if it were a clear break with the past, the Commission proposed to generalize the concept of "mutual recognition" as a central element of the new single-market program.[35]

There were other factors that helped to explain the willingness of member states to consider a great leap forward toward a single market,

34. For cases concerning services, see *Reyners v. The Belgian State* (Case 2/74, [June 1974] ECR 631) and *Van Binsbergen v. Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid* (Case 33/74, [1974] ECR 1299).

35. For a discussion of the history and implications of this principle, see Nicolaïdis (1993).

factors that showed up in the detailed negotiations that were to follow concerning regulations in the various fields of goods and services. Two seemingly barren decades of negotiation aimed at harmonizing national regulations had not been altogether in vain. In the process, as it turned out, national officials had learned a great deal about the regulations of other member countries, evaluating their strengths and identifying their inadequacies. Moreover, in some cases, from food product specifications to physicians' diplomas, member states had already taken substantial steps toward harmonization. Once the political conditions turned favorable, therefore, bureaucrats were better able to identify areas in which the regulations of exporting member states seemed adequate, as well as the provisions that were indispensable to restrain, condition, and manage a Europe-wide regime.

With the formulation of the Single European Act, the Community vigorously moved toward a single market. Among the telling signs that the movement might be having some success was a rapid increase in the relative importance of intra-Community trade. By 1991, trade within the Community reached 60 percent of the total trade of its members, as compared with 50 percent in 1980 (European Community 1992a, 9). At the same time, transborder mergers and acquisitions among enterprises in the common market were increasing at a more rapid rate than mergers and acquisitions between firms within single member countries, a development quite new in Europe's business history. Between 1984 and 1989, the total value of transborder mergers and acquisitions within the Community jumped from $8 billion to $167 billion (Smith and Walter 1991, 3).

Trade in Goods

Taking off from *Cassis de Dijon*, the Community extended its efforts to overcome differences in the national regulations that were impeding the flow of goods inside the common market.[36] Under this approach, two types of situations were envisaged. One was the situation in which national regulations, though different in detail, would be considered as essentially equivalent in purpose and effect. Such cases, it was estimated, would cover the large majority of cases. In those circumstances, member states importing the goods were to accept the regulations of the exporter country as equivalent to their own.

Under the remaining cases, where substantive differences existed among national regulations, the Community developed a two-stage process to ensure that these differences would not impede trade inside the common

36. This new approach was originally stated in "The New Approach Resolution" adopted by the Council in May 1985 (Commission to the European Council 1985, 26).

market. In the first stage, the Council of Ministers would adopt a directive that embodied the "essential requirements" to which any national regulatory system would be expected to adhere, along with guidelines pointing to the means by which such adherence might be achieved. "Essential requirements" would be restricted to basic considerations of safety, health, consumer protection, and environmental protection. Detailed technical standards embodying these essential requirements were left for formulation to private organizations in Europe organized for such purposes, such as the Comité Européen de Normalisation. As far as exporting member countries were concerned, however, products that met the "essential requirements" promulgated by the European Council were entitled to certificates of conformity whether or not they satisfied any technical standards so promulgated. And importing member countries were under an obligation to accept such qualifying certificates.

To implement this approach, the Community needed to ensure that certificates of conformity issued by one member state would be recognized by the others. Thus, in 1990 a "global approach" was initiated by member states' certification bodies. The European Organization for Testing and Certification was created to provide a structure for negotiating mutual recognition agreements and for cooperating in their operation.

Another feature of the new approach was that the Council was prepared to formulate its "essential requirements" by broad product categories rather than by narrowly defined products. By early 1993, 11 such broad directives were adopted, including machine tools, toys, pharmaceuticals, medical devices, and food products (Commission of the European Communities 1993). In earlier discussions aimed at harmonizing national regulations, the products in any one of these broad categories had been the subject of dozens of separate discussions.

Indicative of both the efficacy and the limitations of the new approach was the history of EC efforts to harmonize safety standards in toys. The Toys Safety Directive broke a deadlock of nearly 20 years of stalled harmonization negotiations. It put down stringent criteria regarding flammability and toxicity without spelling out technical specifications for conforming to such criteria (Directive 88/378 EEC, 3 May 1988).

Despite such progress, the new approach has been less effective than many within the Commission envisaged in 1985. The specified requirements still tend to be detailed, lengthy, and difficult to negotiate. On the average, they take about three years to make.

More basic, however, is the question of what the Union has actually achieved under the label of "mutual recognition" when applied to goods. To what extent has the Union simply fobbed off the difficulties of harmonizing national official regulations to private national bodies? To what extent are the solutions of such bodies consistent with the Union's objectives of maintaining open markets inside the Union? Have these bodies managed to avoid the temptation of developing standards that non-

European producers would find especially difficult to meet? Answers to these obvious questions await the careful scrutiny of future researchers.

Trade in Services

Even more difficult and complex has been the range of directives devoted to overcoming the many impediments to the sale of services inside the common market, notably in transport, finance, and information services, and in the practice of medicine, nursing, law, accounting, and teaching. As noted earlier, these restrictions have taken many forms, including those formulated, administered, and enforced by the public bureaucracy, and also those developed by private bodies such as professional associations. The original formulation of the Single European Act envisaged that 54 directives would be required to cover such subjects. But ultimately the total mounted to 84.

In part, the variations in the form and substance of these national measures reflected the different weights that governments placed on various public objectives. In many cases, of course, the object of the restrictions was simply to protect a national market from foreign competition. But in other cases, as in banking and in medicine, a genuine concern for consumer safety provided part of the explanation for some of the government restrictions.

In any event, in relinquishing their controls over the delivery of services by firms from other EC members, host countries have demanded far more extensive limits, conditions, and safeguards than in the sale of goods (Nicolaïdis 1993). Illustrative of the problems involved were two Council directives adopted in 1988 and 1992, covering professional services.[37]

In substance, the first directive deals with the cross-border provision of services in professions whose practice requires a diploma or license, and it establishes a general system for the recognition of diplomas requiring three years or more of study, awarded on completion of professional training. Under the directive, member states cannot refuse to recognize such diplomas awarded by other member countries, thereby opening the door for applicants from other member states.

Following that sweeping grant, however, the directive addresses other problems that so often distinguish the sale of services from that of goods. First, some member countries do not require a diploma for the sale of specified services, as in the United Kingdom and Ireland; instead, private bodies rather than the state recognize the professional accreditation of a barrister or an accountant. For such cases, complex equivalency

37. Council Directive 89/48/EEC of 21 December 1988 and 92/51/EEC (*OJ* January 1989 and July 1992).

rules are laid down. More importantly, host countries retain the right to subject applicants to residual entry requirements where "substantial" differences exist in training between the countries concerned. The host country could require, for instance, a specified amount of professional experience in the home state, the completion of an adaptation period under the responsibility of a qualified professional in the host country, or passage of a test on the subject matter. Given the imprecision of the directive's wording and the widespread resistance of national professional associations to it, provisions such as these are readily abused. Finally, the new system is predicated on the development of an extensive system of mutual monitoring of training requirements among member states that is a far cry from the unqualified reliance on the standards of the service provider's home state (Nicolaïdis 1992). Other key directives in the field of services have reflected different applications of the basic idea of mutual recognition. Thus, the Second Banking Directive, passed by the Council in December 1989, introduced the Single Union banking license, otherwise referred to as the European passport.

The directive attributes the primary task of supervising the financial institutions to the competent authorities of their home state.[38] As with the General Service Directive, however, the banking directive falls short of requiring member states to rely totally on the regulatory controls of home states. Instead, the scope of mutual recognition is restricted to two fields: the initial authorization granted to financial institutions to engage in business and the responsibility to supervise solvency requirements.

Even in the case of initial authorization, however, mutual recognition in banking does not mean that the right of access acquired by financial institutions in the markets of other member states can thus be exercised without any formalities; foreign branches still need to provide host governments with detailed information regarding their financial standing. Moreover, the Second Banking Directive is accompanied by an array of harmonization directives dealing with solvency ratios, accounting rules, supervisory control over major shareholders, deposit guarantee schemes, the monitoring of large exposures of credit institutions, and the transparency of banking operations. Accordingly, the system that has been put in place is closer to a state of "co-regulation" involving the Union and national regulatory authorities than to a simple system of mutual recognition, a feature that reduces the risk of a competitive degradation of national standards.

All told, the Union has sought to carry out the mutual recognition principle as "managed mutual recognition," an approach replete with

38. Council Directive 89/646/EEC of 15 December 1989 on the Coordination of Laws, Regulations and Administrative Provisions relating to the Taking up and Pursuit of the Business of Credit Institutions (*OJ* L386, 1989).

provisions for national authorities to learn about each other and for safeguards that limit the automaticity of the rights of the nationals of other EU countries. Less has been achieved under the new approach than its strongest supporters had hoped. (Only a few dozen lawyers, for instance, have managed to acquire cross-border rights under the new regime.) But the system qualifies, nonetheless, as a remarkable experiment in liberalization (Nicolaïdis 1995, 269-304).

Building Technological Strength

Convinced that the technological gap between Europe and its industrial rivals was growing, Europe's leaders also have sought to narrow the gap by increasing the flow of public financial support, whose source until the early 1980s had mainly been national governments. In 1984, the member states agreed to develop a multiyear framework program to stimulate and support the establishment of what the Commission referred to as an authentic "European Research and Technology Union" (European Community 1988a, 1993). With the negotiation of the Single European Act in 1985, such programs were institutionalized and expanded.[39]

Of the various activities supported under this general heading, the most relevant for competition and trade policy has been a program to provide initial stimuli for technological cooperation among industrial firms in Europe. Of particular importance, in the eyes of Union officials, has been the need to help European industry increase its competitiveness in information technology and telecommunications.

Programs devoted to this goal constituted 45 percent of the total value of the 1987-91 framework program. Foremost among them was ESPRIT, the European Strategic Program for Research and Development in Information Technology, launched in 1984 and designed for a 10-year period. Projects carried out under ESPRIT involve at least two independent industrial partners from different member states and are linked together by an electronic information network, Eurokom.

The first phase of ESPRIT had a budget of 1.5 billion ECUs and financed 219 projects involving 450 partners. In light of the apparent success of the first phase, the budget for the second phase of ESPRIT was doubled. In addition, in 1987, the Community launched the RACE telecommunications program with a 1.5 billion ECU endowment; its principal objective was to develop the technology required for broadband fiber-optic networks. The program, completed in 1995, included about 350 organizations and 2,000 individuals in the course of its existence.

39. The Single European Act added a new article 130f to the treaty that called for supporting the efforts of European undertakings to cooperate with each other, to "become more competitive at the international level."

Strengthening Competition

The efforts of the European Union to support European business, while apparently successful in various respects, at the same time have heightened the tension that has always existed between two lines of EU policy: between ensuring, on the one hand, that European business is amply endowed with the necessary financial, managerial, and technological strength to do battle in world markets, and, on the other hand, maintaining enough internal competition to keep European industry on its toes.

Inevitably, some measures intended to increase the resources of European industry also risked reducing competition in the common market. For instance, encouraging research consortia among European enterprises, coupled with an increase in transborder mergers, may have strengthened the hands of dominant firms.

A new merger regulation responsive to this concern was adopted in 1989. Under it, EC reviews of proposed mergers were to preempt any national reviews, but EC reviews were to be limited to very large firms with substantial business within the common market.[40] The standards for such reviews were quite general, acknowledging both the desirability of strengthening competition and the desirability of promoting technical progress. But one decisive test, according to the regulation, was whether the merger would create or strengthen a dominant position in the common market.

In the five years following the institution of the Commission's new merger powers in September 1990, its staff had received about 400 cases for review. In the exercise of its powers, however, the Commission exhibited an exceedingly cautious approach as it sought to develop appropriate standards (Sandrock and Van Arnheim 1991, 859-74). Some observers complained that the Commission was giving too much weight to the efficiency gains sought by such mergers and not enough weight to consumer welfare effects (Neven, Nuttall, and Seabright 1993). Indeed, by 1996, the Commission had blocked only one merger project, which involved the proposed acquisition of a Canadian commuter aircraft producer by a joint venture of French and Italian firms engaged in the same line of production (*Aerospatiale-Alenia/de Havilland, OJ* 1991, L334/42). Despite the infrequency of such formal actions, however, the parties did alter the conditions of the various proposed mergers during the Commission's investigations.

The merger regulation, it should be noted, applies not only to firms

40. More precisely, the standards defining the area for review of proposed mergers were those that would create an entity whose worldwide revenues exceeded five billion ECUs, had 250 million ECUs of business in the Community by each of at least two of the "undertakings" (that is, the firms concerned), and had not more than two-thirds of that business in a single member country (Downs and Ellison 1991, 54-56).

headquartered within the Community, but also to firms headquartered elsewhere if they otherwise meet the size criteria and other criteria defining the regulations scope. Some member states have worried that such an approach would increase conflicts over extraterritorial jurisdiction, in particular with the United States. Accordingly, in 1991, the Community signed an unprecedented agreement on competition policy with the United States, including an undertaking by the administrations in both to take into account the important interests of the other party at all stages of their enforcement activities. The agreement obliged the parties to notify each other of relevant investigations and to exchange information in order to better understand "economic conditions and theories" relevant to their actions (Jacquemin 1993, 91-102).

In 1996, Boeing's prospective takeover of its rival McDonnell Douglas presented the first serious test of the effectiveness of the US-EU agreement. It remains to be seen if differences in national interests and antitrust concepts would prevent a common approach to such situations.

In addition to stepping up its surveillance of mergers, the Community also reacted to disturbing signs that enterprises might be increasingly organizing themselves in restrictive agreements inside national markets in order to control the sale of goods and services (Swaddled, *Economist*, 24 July 1993, 67).

The grounds for expecting an increase in restrictive business practices and in the abuse of enterprises' dominance have been particularly strong in the case of services. Until the 1980s, the Commission had largely overlooked restrictive agreements in the sale of services, given the other barriers that stood in the way of transborder transactions. With the new initiatives under the Single European Act, however, there were signs that some services' operators were looking actively for arrangements to protect themselves from increased competition. For instance, proprietary computer networks, such as those already existing for ATMs among an exclusionary group of banks and for air reservations among a group of airline companies, seemed to threaten the objectives of Articles 85 and 86. How such issues would eventually be resolved was not clear.

Finally, in the spirit of the Single European Act, the Commission turned to some of the anomalies in the European market for services, such as state-owned monopolies in telecommunications and electric power, that had been tolerated in earlier years. In the second half of the 1980s, some member states had independently started to implement deregulatory programs in these areas. But, in the view of the Commission, these programs were not sufficient to achieve a market without frontiers by 1993. Accordingly, the scope of competition policy was extended to include not only private-sector services, such as banking, but also those provided by the state, such as telecommunications.

The EC approach to the activities of state-owned enterprises in the service sectors, however, reflected some of the limitations of classifying its actions under the dichotomy of competition policy and trade policy. The provisions of the Rome treaty seemed to offer a number of ways to deal with the issue. Articles 30 and 59, endowing the Union with the power to create a common market in goods and services, seemed to offer one channel; Articles 85 and 86, empowering the Commission to strike down barriers to competition and to restrain the use of dominant positions, seemed to offer another; and Article 90, providing some circumscribed powers to the Commission over state enterprises, suggested another avenue. For EC bodies, the distinction was sometimes critical. The Union's powers vis-à-vis the governments of its member states was different in each approach. And inside the Union itself, the relative powers of the Commission and of the Council of Ministers differed in each approach.

Therefore, when in the late 1980s the Commission sought to restrain state telecommunications monopolies from exercising some of their powers of exclusion, it had to decide whether to proceed under the Union's powers over governmental trade restrictions in the common market or under its less-exclusive powers over competition contained in Articles 86 and 90 of the Rome treaty (European Community 1988b). Its decision to use Articles 86 and 90 was subsequently modified by the European Court of Justice, which placed the justification for the action more squarely on EC plenary powers over trade in the common market.

Considerable liberalization was achieved under the program in the years that followed. But some countries clung to their existing monopolies over voice transmission. Eventually, however, the year 1998 was fixed as the deadline for liberalization.

EC efforts to terminate state monopolies in the generation and transportation of gas and electricity have underlined the complexity of the liberalization of services trade. The reasons some of these state monopolies existed, it became apparent, was to control not only production and trade in the affected areas but transportation and distribution as well. Unwilling to deprive national governments altogether of their rights to maintain some measure of control in these cases, the Community began to look for arrangements that would entail some degree of negotiation among the states, such as was already common in the establishment of mutual recognition regimes in other services.

Other decisions in the services area added to the impression of complexity and sometimes seemed almost ad hoc. On the one hand, the Court ruled that the German public employment agency's monopoly in placements for various job categories and the exclusive right of certain designated companies to load ships in the port of Genoa violated Article 86 of the treaty (*French Republic and Others v. Commission*, 23 April 1991; *Höfner v. Macroton*, 10 December 1991). On the other hand, the Court relied on the trade obligations contained in Article 59 to limit some of the exclusive rights of the Greek state television company over the Greek television market (*Ellinki Radiophonia Tileorassi*, 18 June 1991).

From all appearances, the choice between the use of competition policy or trade policy in the context of services has been guided both by questions of practicality and by politics. Because the Commission shares its powers with the Council of Ministers in the application of trade-liberalization provisions, activists in the Commission sought to control state monopolies through the antitrust provisions, where the Commission exercises almost exclusive jurisdiction. But the ministers representing the member states and the Court have preferred to rely on the trade-liberalization provisions as the platform for EC actions against these state monopolies.

Conclusions

By the terms of the Rome treaty, both the trade policies and the competition policies of the European Union are tilted toward improving market efficiency by reducing or eliminating barriers erected by governments or firms. Although the Community (and its successor, the European Union) has pursued those objectives by fits and starts over the decades of its existence, and although some of its programs can be seen as significant departures from the trend, the basic direction has been maintained, testimony to the power of a continuous learning process. But, of course, the Community's goals, as well as its preferred means of achieving them, have been quite different for trade between its members than for trade with outside countries.

In the internal market, the dominant goal of both competition policy and trade policy is to overcome the restrictions that would separate national markets from one another; exceptions to that general principle must bear a heavy burden of proof of their compelling necessity. In dealing with other countries, however, the Union incorporates the usual caveats that typify the behavior of countries in international trade, including an insistence on maintaining special restrictions for agriculture, a reservation with respect to measures that might impose serious injury on any industry in the Union, and a readiness to impose restrictions in individual cases without prior authorization from any external source.

The differences in the Union's approach to problems in the internal and the external front are especially marked in other respects. Where the internal market may be affected, the Union maintains extensive programs aimed at restraining measures, such as cartel agreements and state subsidies, that imperil market efficiency. But when the effect of such measures would be borne largely by outside countries, as in aircraft manufacture, the restraints on such practices are few. In this respect, of course, EU practices are not unlike those of most other countries.

Inside the common market, the Union has relied on competition policy to deal with some problems that would otherwise be addressed by trade policy, such as dumping. Exceptionally, however, the Union has sometimes been obliged to tolerate restraints inside the common market in response to pressures from member countries, a situation reflected in persistent price dispersion in some products.

One of the Union's major contributions, from which the rest of the world could learn, has been its attempts to overcome the distortions and restraints in the internal market that arise as a result of different regulatory approaches among its member states, notably approaches to consumer protection, health, and the environment, and as a result of state monopolies such as those found in electric power and telecommunications. Such restraints have received far less attention in the past from economists and policymakers than their impact on trade appears to warrant. Restraints such as these affect trade in both goods and services, but they are especially important in the services sector. The measures taken by the Union to deal with such issues cannot be easily classified under either the competition policy or the trade policy rubric, as they are ordinarily defined. Commonly, they entail extensive negotiation among the states involved, and they restrict the movement of goods and services across borders and limit the freedom of firms to develop cross-border alliances.

Finally, if the lessons of the Union can be generalized, they teach that the effective development of competition policy, as well as of the hybrid measures associated with regulatory regimes, demands a much more elaborate apparatus among the countries concerned than now exists in international regimes in the trade policy field. The facts to be established and the judgments made in competition cases are far more nuanced than in trade cases. The bodies rendering judgments in competition cases, therefore, are much more vulnerable to challenges on the merits of their decisions. The effectiveness of EU institutions in competition cases is explained in considerable part by the extraordinary powers with which the founding treaties endowed them. Until that fact is recognized, governments in the rest of the world are unlikely to be able to replace trade policy effectively with competition policy.

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