Economic Law as an Economic Good

Its Rule Function and its Tool Function in the Competition of Systems

Edited by
Karl M. Meessen

in cooperation with
Marc Bungenberg and Adelheid Puttler

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Karl Meessen

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Introduction

Economic Law as an Economic Good: Its Rule Function and its Tool Function in the Competition of Systems

Karl M. Meessen[*]

To some extent, business can choose the economic law it wishes to govern its activities. The traditional way of doing so is to directly choose the contract law applicable to a specific transaction, subject, of course, to such internationally mandatory rules of law as may be applicable under the lex fori or the lex arbitri.[1] Choosing contract law in that way has its implications for the legal services industry. Hence those responsible for the making of contract law in England and in the state of New York, to name but the two legal systems often chosen in international transactions, make sure that the respective laws do not lose their attractiveness by an overdose of well intended or just ideosyncratic restrictions on the freedom of contract. There is, however, a second more indirect way of choosing the applicable law. Technically speaking, it is by choosing the "points of contract" liable to trigger the applicability of one or more particular economic laws through localizing business activities in one or more particular states. That can mean avoiding investment of capital in places where there is a political risk of expropriation, or it can mean avoiding trading in goods at places where obtaining government consent to certain activities, or the enforcement of contracts, is dependent on the payment of bribes. Put the other way around, business is usually attracted to places where a competitive environment welcomes new entrants into the market, and thus, where effectiveness, innovativeness and other virtues of business performance are likely to be rewarded.

Governments, or the clever ones among them, are aware of the factors guiding business activities. In the course of adopting and enforcing economic legislation, they seek to attract business activities in order to increase the national income (and fiscal revenues), generate employment opportunities and, very generally, please voters.[2] Hence, economic law may, as suggested in the title of this book, be considered an economic good. It is a public good offered in the expectation of secondary benefits to be derived from the localization of business activities throughout the world.

The subtitle states the two functions of economic law. Economic law is not only a "tool", that is, an instrument in the pursuit of such interjurisdictional competition among states and supranational organizations, such as the European Union. Economic law also

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[1] Meessen, *Economic Law in Globalizing Markets* (2004), p. 145, 295; (generally) p. 139 et seq., 293 seq.

[2] Meessen (note 1), p. 9 et seq. with further references.

has a rule function in the competition of systems. The way that function operates varies depending on the context.

Most of the rules of WTO law, for instance, promote not only the competition among enterprises but also interjurisdictional competition as part of a broader competition of systems. The more freely business can choose the location of its activities, the more pressure it exerts upon states to enhance the attractiveness of the economic laws they are making. That pressure results from the increased ease with which business can relocate its activities. In fact, such easing of exit from, and entry into, markets is the essential contribution WTO law is making to the competition of systems. International standards, whether set by a WTO agreement or any other convention, are ambivalent. They ease cross-border trade but, at the same time, they bring to an end the competition for the right standard. That competition for standards can evolve as a race to the top or as a race to the bottom. The metaphorical distinction between top and bottom is misleading in so far as it is an open question whether business values more highly the top of tight regulation or the bottom of loose regulation. It is for the market, in a Hayekian process of discovery,[3] to find out the direction the race will take.

The banking crisis of 2008 is at present developing into a fully-fledged economic crisis of worldwide dimension. In tackling the current crisis, there is much talk of coordinated action. The action so far undertaken on state level, however, clearly bears witness to another lively round in the ongoing competition of systems. Given an increased role of governments within the economy, competition among them is, if anything, bound to gain further momentum.

Whenever the making of economic law is involved, heed should be taken of its dual function as a rule and as a tool in the competition of systems. Assessing those secondary functions of each and every rule of economic law may also contribute to the proper application of the respective rule in legal practice. In addition, economic and political theory may draw benefit from a better understanding of the political economy of the competitive, as opposed to the harmonized or cartelized, making of economic law.

The very elusiveness of the various functions of economic law as a rule and as a tool is at the core of this collection of essays. The essays assembled in this book were, with two exceptions, elaborated on the basis of papers presented and extensively discussed at a symposium of academics and practitioners of law and economics, from inside and outside Germany, held in Düsseldorf from 2 to 4 November 2007. Before giving a survey of those studies (Section B), it may be appropriate to take, in Section A, a look at the notion of competition since competition is the element common to both the interaction among companies in the market and the interaction among states and supranational organizations. The survey of the papers to be given in Section B will be followed by some tentative conclusions sketched out at the end of this introductory note (Section C).

A. The Competition Principle

To lawyers familiar with competition law, and to economists familiar with competition theory, the term "competition" refers to the competition between enterprises in the framework of such national or supranational competition law or laws as may be applicable

[3] Hayek, *Der Wettbewerb als Entdeckungsverfahren* (1968).

to the particular case situation. The competition between enterprises certainly is the type of competition most extensively discussed and most sophisticatedly analysed in scientific theory. But it is just one type of competition among many others.

The process of competition is in fact a general phenomenon characterizing a type of interaction among human beings or rather among organisms of any kind. Animals compete for food, for sexual partners and for a place to rest. Even plants stretch themselves to reach more sunshine than neighbouring plants. Bacteria and other micro-organisms fight for supremacy. The evolution of organic nature has aptly been described as a quest for the "survival of the fittest" ever since *Charles Darwin* incorporated that term in the 4th edition of 1869 of his "The Origin of Species" of 1859. The underlying theory has remained uncontested. It has been refined and confirmed by modern molecular biology.[4]

Competition is a principle of life. In that general perception, competition can be described as an open-ended process involving two or more players of an equal or a different structure, all of them striving for some benefit, even if at the expense of other players. The competitive process tends to fully exploit physical and intellectual resources of each player. The resulting high performance continuously generates positive externalities in terms of biological, scientific, technical and economic progress to the benefit of a multitude of human beings and/or other organisms.

If asked to give an example of competition, competition in sports and competition in politics probably first spring to the mind of anyone who does not happen to be an economist or a lawyer. Sports may even have an archetypical value in explaining what competition is about. The time element in sports is most telling, and so is its rule bound, though not always rule abiding, character. In politics, rule abidance is less common. Nonetheless, it may produce comparable rewards in terms of power and perks.

As to the competition of systems, a struggle among states and other political units for superiority can be observed throughout the known history of mankind. Internecine wars have been, and still are, its common feature. At times of peace, a considerable amount of struggle is going on as well, just at a level short of warfare.[5] There is nothing new about that competition to proceed by way of forging one's own legal, social, cultural, economic and/or political system. As a result of worldwide liberalization, it has, however, become more intense during the last couple of decades.

In economic literature, a decisive insight is owed to one of those short seminal articles that have from time to time offered a new paradigm to the economic understanding of political and social processes. The reference is to *Charles M. Tiebout's* 9-page piece of 1956,[6] in which he explained some of the factors liable to channel economic activity to certain locations. While Tiebout discussed a phenomenon observed on the level of local government, the more voluminous studies that followed his pioneering article examined the competition among states within a federation,[7] among member states of

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4 For a recent assessment see Kirschner & Gerhart, *The Plausibility of Life* (2005); see also Edelman, *Neural Darwinism* (1987); for the common elements of economic and biological phenomena see Hayek, *The Sensory Order* (1952).

5 Morgenthau & Thompson, *Politics among Nations*, 6th ed. (1985); for recent studies with an emphasis on economic aspects see Porter, *The Competitive Advantage of Nations* (1990); Olson, *Power and Prosperity* (2000).

6 Tiebout, *A Pure Theory of Local Expenditures*, 64 J.Pol.Econ. 416 (1956).

7 Bratton & McCahery, *The New Economics of Jurisdictional Competition, Devolutionary Federalism in a Second-Best World*, 86 Geo.L.J. 201 (1997).

a supranational organization, such as the European Union,[8] and among all of the 190 or so sovereign states of the world.[9]

It is the EUwide and global context that set the framework for this collection of studies. As regards economic law, subunits of states are of lesser interest. The legislative competences for economic law have usually been lifted to the federal level under some general commerce clause. But there are exceptions. Thus the prime example for a race to the bottom is the competition supposed to be taking place among corporation laws adopted on state level in the United States of America.[10]

B. Survey of the Papers

The following survey provides an idea of the overall contents of this volume and highlights those elements that have a particular bearing on its general theme. While falling short of abstracts written by the respective authors, it may help each user set up a reading strategy of his or her own. The account is divided into three parts allowing, however, for considerable overlap: *I. Theoretical Considerations*, *II. Across the Fields of Economic Law* and *III. Interjurisdictional Competition in Progress*.

I. Theoretical Considerations

Wolfgang Kerber's[11] chapter on "The Theory of Regulatory Competition and Competition Law" (p. 27) puts on display a fully-fledged theory of regulatory competition as part of the competition of systems. He distinguishes between four ways of competing based on the mobility of: (1) laws, (2) firms, (3) goods and (4) information. Relating competition law to those categories, he observes that the applicability of competition law under the effects doctrine does not allow for a free choice among "mobile" laws. To avoid the applicability of a particular competition law, business would have to renounce trading in that market, which usually is too high a price to pay. Business can, however, actively exploit the benefits expected from a well enforced system of competition law through focussing its activities on that particular market. In addition, states may, as *Kerber* puts it, pursue a "strategic competition policy" through exempting foreign related activities from the constraints of domestic competition law. *Kerber* criticizes that approach as a "beggar-thy-neighbour policy" even though any "neighbouring" state would be capable of fending off anticompetitive domestic effects by enforcing its own competition law under that same doctrine. Generally, and with regard to competition law in particular, *Kerber* pleads for a sound mix of some harmonization combined with some leeway for ongoing regulatory competition. In that vein, he commends the International Competition Network for its contribution to convergence driven by continuous yardstick competition. He warns,

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[8] Kerber, *Interjurisdictional Competition within the European Union*, 23 Fordham Int'l L.J. 217 (2000).

[9] S. Sinn, *Competition for Capital* (1993); Siebert (ed.), *Locational Competition in the World Economy* (1995); Breton, *Competitive Governments* (1996).

[10] Easterbrook & Fischel, *The Economic Structure of Corporate Law* (1991).

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however, against too many "codes of good practices". He expects them to stifle the innovative development of that field of law. In concluding, *Kerber* reiterates his call for a body of rules allocating competences among the various levels of rule-making.

In his paper on "Economic Law Between Harmonization and Competition: The Law & Economics Approach" (p. 45), *Peter Behrens*[12] approaches the subject from a slightly different angle. In the beginning explaining his methods of assessing the effects of the rules of economic law, which he divides into "enabling laws" and "corrective regulations", he proposes to perceive the economic law object of regulatory competition as being traded in bundles of heterogeneous laws and as often additionally combined with non-legal public goods liable to be affected by any "exit" strategy. In transferring the market paradigm to jurisdictional competition, he agrees with identifying governments as the sellers in that market, but ascribes the buyer's role to consumer-voters rather than to enterprises. Yet in the international context, consumer-voters, through retaining the final word ("voice") on government performance in elections, differ from enterprises, who can easily shift activities from one country to another ("exit"). That conceptual difference, however, leaves unaffected his conclusions on the function of harmonization, which he confines to fending off market failures specific to interjurisdictional competition. Such market failures may result from informational asymmetries, free-riding with regard to internationally accessible public goods and looking for economies of scale in the production of public goods.

Writing on "Economic Constitution, the Constitution of Politics and Interjurisdictional Competition" (p. 61), *Viktor Vanberg*[13] distinguishes between two types of constitutions, but sees them linked by interjurisdictional competition. Since establishing the political constitution has remained a domain of the national level, the rules of the competition-of-systems game have to be derived from the economic constitution, which happens to be mainly embodied in the WTO agreement as an instrument of international law binding a multitude of states. He describes the economic constitution, that is, WTO law, as sustaining and facilitating the exit option of business through the liberalization of cross-border trade and investment. Only on that basis can both the knowledge gap of citizen-voters be filled and the special interest problem of rent-seeking groups be constrained. In the end, it is the interdependence of the two constitutions that provides better informed policy choices and curbs the incentives for privilege-seeking.

Erich Schanze's[14] chapter on "Assessing the Impact of Economic Law" (p. 65) raises a question that, in jurisdictional competition, both the supply-side of states and the demand-side of business enterprises have to put to themselves, beforehand and in hindsight. In the beginning, *Schanze* points out that he favours a "microconstitutionalist" approach, under which the making of economic law is claimed to result from an interaction of public and private policy-makers. That description of the decision-making process, however, relieves neither side from a proper impact assessment, which must proceed from more or less subjective assumptions of plausibility with regard to the collected empirical data. The aggregation of subjective assumptions to business climate indices constitutes a first step of empirical analysis. It is said to have but occasionally been compounded by studies based on rigorous field research with regard to a particular industry. In his conclusion, *Schanze*

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expects symbiotic relationships to be forged between diverse partners, who would then share the risks revealed by the prognostic impact assessments he proposes.

On the basis of data compiled and published by the Fraser Institute (Canada), *Dietmar Meyersiek*[15] propounds an unequivocal message on what business is heading for in his paper on "The Fallacy of Cultivating the Home Turf: A Business Perspective" (p. 75). He describes business as attributing considerable weight to the legal environment since economic performance is positively correlated to the quality of a country's legal system and since the quality of a legal system is mainly determined by the amount of freedom accorded to business operations. Business, being used to operating under conditions well short of scientific certainty, nonetheless determines the direction to take. *Meyersiek* leaves open whether the assessment of the situation by business, with its impact on the theory of interjurisdictional competition, is also and at all times shared by government, or whether government prefers getting talked into cultivating its home turf by some special interest group.

In his paper on "Economic Law as an Economic Good: Reflections of a European Judge" (p. 91), *David Edward*[16] analyses the title of this volume, which also was the main theme of the symposium. His analysis leads him to challenge the soundness of the whole concept in many ways. Setting the higher goal of producing "good" economic law, he finds that "interjurisdictional competition" hardly has anything to contribute to the attainment of that goal. In view of "Orwellian" labels, which he finds to have been attached to European centralization by other speakers, he shows himself weary of the endless Europe wide debate on subsidiarity triggered by the Maastricht Treaty. Regulatory competition, he believes, is lacking the tight standards necessary to cope with the problem at hand, which is financial control in the example he has chosen. Concerns regarding the "race-to-the-bottom syndrome", as economists would put it, make him generally question the transferability of the competition paradigm from the business context to the one of relations between state law-makers. In his opinion, economic-law-making should confine itself to striving for the support of positive, and the suppression of negative, tendencies of human conduct.

II. Across the Fields of Economic Law

Starting the move across the fields of economic law, *Matteo Ortino*[17] propounds to conceive economic law as one and a whole in his piece on "The Notion of Economic Law and Regulatory Competition" (p. 103). *Ortino* conceptualizes economic law as a field of law in its own right. It amalgamates elements of private and public law to form an efficiency-oriented body of rules taken from every level of a multilayered system of rule-making. Spotting elements of rule-making by business itself, he pleads to define economic law merely by reference to its economic subject matter. Correspondingly, he considers business rule-makers also to be partly involved in the global competition of systems alongside state rule-makers at the various levels. Referring to Italian banking supervision,

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he goes on to include in that competition different agencies as potential rivals for goals of "efficiency and effectiveness". Given this broad approach to economic law in general, there is no need for him to proceed to formulating specific views on how to attribute rule and/or tool functions to the one or other part of economic law.

1. Covering Several Fields

In their paper on "Public Economic Law as the Law of Market Regulation" (p. 115), *Stefan Lorenzmeier*[18] and *Reiner Schmidt*[19] take the public administrative law as their starting point and examine the evolution of administrative law in an era of privatizing and liberalizing government functions. Governance has become, the authors point out, increasingly tied to economic efficiency and effectiveness. Instead of acting on their own, government agencies guarantee standards and monitor performance. Under the "new steering model" of modern administrative organization theory, even budgeting is reported to comprise competitive elements enhancing efficiency. The role of WTO law with regard to state aid and public procurement is positively noted by the two authors. Given their approach, their views on what is and what should be left to interjurisdictional competition remain unstated, that is, except for a plea for global competition law.

Hannah Buxbaum's[20] paper on "Competition in the Private Enforcement of Regulatory Law" (p. 129) briefly mentions the ubiquity of yardstick competition. With regard to substantive law remedies and their procedural framework, her focus is on legislation permitting forum-shopping, especially in competition law and in securities litigation. The United States, *Buxbaum* explains, have recently been joined by Canada and the High Court of England as players in that market of adjudicative functions. She finds a further expansion to be underway due to efforts of the European Commission. The merits she attributes to that competition include an increase of business for the legal services industry and an increase of deterrence in the enforcement of competition law. But she fears over-deterrence might undermine leniency schemes. Another downside she sees is related to the disruptive effects on international relations, which makes her eventually plead for a – judicial or arbitral – settlement of jurisdictional conflicts regarding issues of forum-shopping.

2. Commercial Contracts

In his paper on "Enforcing Contractual Claims: From Schmitthoff to Investment Arbitration" (p. 139), *Norbert Horn*[21] sets out by stating his unease with modelling economic law as an economic good. He then, however, proceeds to identifying a number of "competitive mechanisms" giving shape to today's world of enforcing commercial law. His focus is on contract law governing cross-border transactions. Referring to the competition between arbitration centres for arbitration business, which is supported by legislation on arbitration by the respective states, he draws attention to the competition between

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agencies and informal groups of scholars formulating codes of contract law. In arbitration, private parties can give those codes a role in supporting the interpretation of, or serving as a substitute for, national or international contract law. *Horn* also acknowledges the influence the quality of legal systems exerts on the cross-border flows of trade and investment, with the suppression of corrupt practices as a key indicator. Yet international investment arbitration, he outlines thereafter, has proved an effective alternative to state enforcement of debts.

Harald Joos's[22] elaboration of the after-dinner speech on "Dealing with Foreign Governments" (p. 149) he delivered during the conference gives an account of personal experiences. As a result of his company's zero-tolerance policy regarding illicit payments, advance scrutiny might, he firmly believes, rule out the one or other venue for major business activities. In India, he came to realize that exporting cranes to Indian port authorities is intimately linked to India's demand for a lowering of the tariffs levied on its agricultural exports. Otherwise, he fears Indian import duties on his company's products might easily be increased instead of being reduced according to current plans. Turning to an example of intra-state competition, he then reports Chinese representatives of local government to have quickly and favourably responded to his company's suggestions that other locations in China might also be available for investment. As to South Africa, his point was that, together with other foreign investors, it proved possible to find a slightly watered down way of how to comply with the requirements of local shareholding in the "Broad-Based Black Economic Empowerment Act" of 2003. The overall message of the paper is that good contacts with every level of host state government were of critical importance.

With Germany's biggest steel company's two recent overseas investments (in the United States and in Brazil) in mind, *Klaus Gründler*[23] uses his paper on "Investors Selecting Locations for Investment" (p. 153) to present and discuss a check-list of factors to be considered when planning foreign investment. He describes foreign investment as cost-driven and/or market-driven. As seen from that perspective, economic law comes in as part of the "legal framework", which is considered to form part of the "business climate", in turn listed among sundry "soft factors". In contrast to that low profile, he then proceeds to ascribing cost relevance and/or market relevance not only to tax law and labour law but also to tariff and non-tariff barriers including state aid as well as to environmental law, corrupt practices law, competition law and, in the case of the United States, procedural rules affecting the probability of an investor becoming embroiled in time and cost consuming litigation.

3. Securities Law

In their chapter on "The Competition of Systems in the Market for Listings" (p. 167), *Arthur* B. *Laby*[24] and *John Broussard*[25] present empirical evidence refuting the widely held assumption that the U.S. Sarbanes-Oxley Act of 2002 prompted foreign companies to delist in the United States and turn to less demanding non-U.S. stock exchanges where

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they would meet their capital needs. The particularly demanding character of the provisions of that act is not denied. On the contrary, the act is described as a "watershed". It made securities law pursue corporate governance objectives in addition to its monitoring purposes. In detailing the contents of the 2002 legislation, the two authors note certain adaptations of the act to such legal requirements as may follow from foreign laws that also happen to be applicable to foreign companies covered by the act. From economic data collected after the act's entry into force, *Laby* and *Broussard* conclude that the foreign companies whose operations were less successful happened to be those that delisted. The authors surmise that unwelcome transparency, on the one hand, and a preceding loss of the commercial capacity to gain access to the U.S. capital market, on the other, prompted the delisting. With regard to interjurisdictional competition, one is tempted to conclude that the Sarbanes-Oxley Act was aiming at the "top" by admitting to the U.S. capital market only the foreign companies able to make it.

In his paper on "Non-U.S. Clients' Reactions to Sarbanes Oxley" (p. 187), *Klaus-Michael Thelemann*[26] confirms the findings of *Laby* and *Broussard* from the perspective of an adviser of foreign addressees of the Sarbanes-Oxley Act. According to his report, the management of non-U.S. companies often failed to adequately arrange for compliance with the act. Instead of reviewing current systems of internal control, compliance was delegated to a low level, whose incompetent handling eventually forced the company to ask for extensions of the time limit. According to the data *Thelemann* presents, early compliers regularly outperformed latecomers.

Douglas Arner[27] does not look at a specific piece of legislation but at "The Competition of Financial Centres and the Role of Law" (p. 193). The hierarchical "hub-and-spoke" network that is increasingly superseded by direct access, financial centres can be categorized by geographical coverage and focus on particular subject matter. The centres are, however, all found to need "institutional underpinnings of governance and public order, property rights and their protection, contract enforcement and dispute resolution". The area where one centre can excel over another is stated to be related to financial regulation, not only in securities, but also in derivatives and in banking. In the latter respect, London and New York are reported to have scored widely observed failures in the Northern Rock und Bear Stearns cases (to which other failures of those and other centres would meanwhile have to be added). Openness to financial innovation is identified as the critical parameter of the competition between financial centres. In that respect, *Arner* finds innovative capacity to be inherent in common law systems but not in systems of civil law.

4. Intellectual Property Law

At the beginning of his paper on "The Territorial Dimension of Intellectual Property Law" (p. 213), *Volker Michael Jänich*[28] raises the question whether intellectual property law has any influence on the choice of location. Only marginally so, is how his answer can be summarized. Protection is, as suggested by the title of *Jänich*'s paper, only grant-

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ed within the state where it is obtained either through "creation" in copyright law or through "registration" of other intellectual property rights. But territorial protection is widely granted by a number of international and European conventions. That leaves the option to attract "copycats" open only to the relatively few states that are not bound by those conventions. The exception to the rule is employee invention law, which varies from state to state. Since many states provide no rules on that matter at all, business can theoretically avoid employee compensation through the choice of a particular site for research & development activities at the risk, however, of diminishing the motivation to innovate (and/or to disclose innovations).

In his paper on "Patent Law as an Investment Factor?" (p. 221), *Peter Kather*[29] details *Jänich*'s account with regard to that particular intellectual property right. The concept of patentability is found to have its limits, and the handling of those limits to fall well short of a uniform approach. The observation relates to biotechnological developments, which is reported to allow for some choice between European Union and member state filings, and also to software, which is patentable only as part of a particular hardware product. Furthermore, in the case of patent infringement, sanctions vary from state to state regarding the amount of damages to be granted and regarding the taking of evidence. In the latter respect, *Kather* mentions a plaintiff friendly practice of the Düsseldorf courts that deviates from the other German courts. According to the figures given by *Kather*, the Düsseldorf courts have ended up with taking about a third of the patent infringement lawsuits filed in the entire European Union – to the benefit of the Düsseldorf bar specialized in that sector.

Rembert Niebel[30] also identifies a couple of competitive elements in what he calls "Worldwide Trademark Management" (p. 233). He sets out, however, by giving a figure attributing legal considerations a share of just 9 % in the process of deciding whether or not to resort to trademark protection when developing a marketing strategy. The worldwide harmonization is reported to have been put in place well ahead of the current process of economic globalization. But harmonized protection is not available to every type of trademark. Suggestive word marks, mere colours, three dimensional marks etc. are protected in some countries but not in others. *Niebel* doubts that any resulting unavailability of trademark protection would induce businesses to refrain from marketing their product at such places. But he describes subtle ways of exploiting the exhaustion principle of IP law in a strategy of simultaneously marketing old and new products of the same kind. Given the gist of that account, any assumption of a lively interjurisdictional competition between governments regarding the options involved would seem farfetched.

5. Competition Law

Friedl Weiss[31] discusses "Competition as a WTO Subject" (p. 243). His estimate is that 90 % of world trade is covered by competition laws already in operation. The main questions, to which he consistently returns, are: is it in those circumstances necessary to establish mandatory rules of WTO law?, and, to what extent would it be politically feasible? Addressing those questions, *Weiss* presents a broad spectrum of factors to be

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considered. He pays particular attention to what he calls the "competition-law related terms-of-trade spillovers" laid down in existing WTO agreements or developed by the WTO Panel and Appellate Body practice, such as the Kodak/Fuji and the Mexican Telecom cases. Reviewing elements for additional WTO rules on competition, he finds that any possible procedural obligations are contained already in existing OECD recommendations. In his opinion, most of the proposals to harmonize substantive competition law remain quite controversial, especially with regard to outlawing vertical agreements that have an impact on market access or with regard to providing for general exceptions to the application of competition law.

A current problem worrying many practitioners is discussed in *Romina Polley's*[32] piece on "Obtaining Leniency in the ECN Framework of Parallel Competences" (p. 269). The room for competition in the leniency context eventually spotted by *Polley* is that which occurs among national competition authorities with success being defined as eventually handling the case (and collecting the fine). For the remainder, the paper reads as a plea to harmonize leniency procedures. *Polley* argues that first movers (to be granted immunity under the programs) and second movers (to be granted a reduction of the fine) should obtain some sort of a marker, which would guarantee the chronological order in which they informed an enforcement agency. That order should, if possible, also be binding upon enforcement agencies of other member states that are investigating the same case or will do so later. Furthermore, continuously comparing the effects of the various leniency programs, *Polley* offers another example of how to maintain incentives for voluntary disclosure in an environment of interjurisdictional competition.

In his paper "Exporting Competition Policy: From Soft Pressures to Shared Values" (p. 279), *Andreas Weitbrecht*[33] takes the main theme (Economic Law as an Economic Good) quite literally and examines when, where and for what reasons competition law has been exported since it was invented back in 1890. Only after World War II, the United States started exporting its antitrust laws, first to Germany and Japan, then to the European Coal and Steel Community of 1951. Germany and the ECSC re-exported competition law to the European Economic Community from where it was moved on to the other member states and eventually to Eastern Europe. While some of the exporting is described as having taken place for political reasons (keeping the Third Reich war machine dissolved in Germany) and for market access reasons (Japan in 1980s and 1990s), *Weitbrecht* stresses the paramount self-interest of importing states in making their economies flourish by attracting the strongest performers. In addition, *Weitbrecht* sees a second channel in operation: the extraterritorial application of domestic law, which (actually also starting in 1945 with the adoption of the effects doctrine in Alcoa v. U.S.) always tends to make the strictest law and the strictest enforcement practice prevail. His personal preference, however, is for "soft harmonization" on the basis of "shared values", which is a process at present facilitated by the International Competition Network.

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III. Venues of Systems Competition

The following papers focus on efforts of harmonization in a particular geographic context. Again, these papers show considerable overlap with the ones in the two preceding sections on the theory of interjurisdictional competition and on the various fields of economic law.

1. World Trade Organization

"Where Trade Policy Stands Today" (p. 291), presented by *Richard Senti*,[34] gives a sobering account of the state of the WTO. The Doha Round of trade negotiations having got stuck, he proposes a "reorganization round". Its task would be to try and reconcile the ever expanding number of bilateral and regional agreements with the venerable set of GATT/WTO principles of most favoured nation treatment and multilaterality. For the time being, he observes not only a reciprocity driven trend towards higher tariff and non-tariff barriers to trade but also a distinct change in the decision-making process with contracting parties no longer acting individually but as members of one or other regional group. Furthermore, he sees an urgent need for solving the organizational problems resulting from the – partly helpful, partly harmful – WTO related activism of non-governmental organizations. Favourable comments are reserved for the WTO system of dispute settlement as adopted at the end of the Uruguay Round and further developed in WTO practice ever since.

Federico Ortino[35] addresses the institutional linkage, missed by *Senti*, between non-governmental organizations and the WTO, and identifies a modest amount of openness of the WTO (and also of the NAFTA) towards civil society in his paper on "The Impact of amicus curiae Briefs on the Settlement of Trade and Investment Disputes" (p. 301). Amicus briefs filed by non-governmental organizations in two cases decided by the WTO Appellate Body and a NAFTA arbitral tribunal respectively are supposed to provide a promising beginning of a linkage to civil society: In the *Shrimp/Turtle* case, the Appellate Body took account of briefs submitted by environmental organisations without explicitly referring to them. *Ortino* points out that a NAFTA arbitral tribunal adopted a similar position in the *Methanex* case. Those two cases, he argues, stand for some degree of procedural and substantive openness towards influences of civil society. By way of conclusion, one is tempted to put arbitral law-making on record as another form of harmonization with the effect of reducing the competition among environmental laws.

In his paper on "The Constitutionalization of International Economic Law" (p. 317), *Thomas Cottier*[36] perceives WTO law as the centre piece of a global constitution. That constitution is stated to consist not only of the classic GATT/WTO principles of non-discrimination but also of the principles, such as the rule of law, transparency and proportionality, commonly forming part of any national constitution. For support of that assumption de lege lata, he refers to a doctrine developed mainly by Swiss authors to the effect that, given the breadth of the economic law contents of the WTO agreements, those general principles of constitutional law are inherent in any multilayered legal sys-

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tem. *Cottier,* however, stresses that the WTO constitution still needs to be supplemented by rules providing for a more equitable income distribution among states and also within states. In the course of presenting his thesis, he also draws attention to the multiple forms of harmonization and cites Switzerland's voluntary emulation of EU rules as an example for a non-member's policy of "eurocompatibility".

2. European Union

Werner Mussler[37] takes a straight look at the real world of European integration in his report on "Intra-EU Systems Competition" (p. 337). Taxation and civil law, the one despite considerable industry pressure towards a level playing field and the other despite considerable academic efforts of harmonization, have in his opinion remained fields of law where competition among member states is still active. The explanation *Mussler* offers is that such fields somehow reflect "national sovereignty". Even in fields where the decision-making power has been transferred to Brussels, member state governments can, and do, make sure that the decisions are actually taken in a competitive process. Each player in the four cases reported by *Mussler* did its very best to try and transfer costs to others while reaping the benefits, by capping emissions of small cars (produced in France and Italy) or big cars (produced in Germany), by imposing emission standards on this or that industry or by unbundling energy groups. His fourth case relates to the Galileo project. Originally, it was supposed to exclusively rely on private funding but member states managed to have it exclusively financed from EC funds and topped that achievement by obtaining the permission to set up a consortium of member state suppliers as bidders. In *Mussler's* view, the normal strategy of member states in the Council consists of "a mixture of competing and colluding".

In his paper on "Competition in and from the Harmonization of Private International Law" (p. 353), *Ronald A. Brand*[38] gives an account of the negotiation process leading to the adoption of the Hague Convention on Choice of Court Agreements of 2005. Theoretically, he sees that process to give room for competition in no less than four different ways: (1) between the EU and its member states for the negotiating competence with third states, (2) between EU member states to shape the European position regarding the contents of the convention, (3) between the negotiating parties regarding that same issue, and (4) for competition between contracting states to offer "magnet commercial courts" to be chosen by transnational merchants. According to *Brand,* only the fourth and last scenario for competition still has a chance of becoming effective in practice. Competition no. 1 for the pertinent external competence was terminated by a Court of Justice opinion on a related matter under a trade relations rationale. As for the intra-Community competition for a negotiating position (no. 2), nothing much could be done since the six original member states had made their civil law position part of the acquis communautaire before the United Kingdom entered the Community and could explain the merits of common law. As to competition no. 3, third states are reported to have been lucky to fend off a clause that would have given the internal law of the EU precedence over the convention even in cases where one of the parties is domiciled outside the EU. What is left is the convention itself, whose scheme of mutual recognition of judgments

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may allow for a competition among states trying to channel legal services business into their courts.

Sharing *Mussler's* and *Brand's* diagnosis, *Roland Vaubel*[39] uses his paper on "The European Constitution and Interjurisdictional Competition" (p. 369) to report and explain key elements of a constitutional project a private group of professors, mainly of economics, has put forward as an alternative to the Lisbon Treaty, whose ratification still remains pending. He prepares the ground for his position by citing political philosophers from *David Hume* to *Max Weber,* all of whom praised the virtues of competition among the states of Europe in its traditional political fragmentation. To his mind, a European constitution should therefore limit and curtail rather than support the natural trend towards centralization. He explains four proposals for how such a truly constitutional function could be established: (1) the power of initiative for new legislation should be transferred from the Commission to the Parliament and the Council, (2) a second chamber composed of representatives of member state parliaments should be established, (3) jurisdictional disputes should be referred to a second European court composed of representatives of the highest member state courts, and (4) member state parliaments should be given a share in the decision-making process concerning EU legislation.

3. Other Regional Groupings

Werner Scholtz[40] contributes a paper on "Environmental harmonization in the SADC Region: An Acute Case of Asymmetry" (p. 385). The initials SADC stand for South African Development Corporation, which is an international organization, composed of the Republic of South Africa and 13 other states of the Sub-Saharan region of Africa. The SADC is looking forward to economic union by 2034. Among its member states, South Africa excels by its advanced stage of economic development and the size of its economy, which is said to be greater than the economies of all the other member states combined. Given the resulting divergence of environmental standards and their enforcement, *Scholtz* looks for appropriate ways of such harmonization, which he considers necessary to reduce costs, to provide incentives for innovation and to avoid free-riding. In his opinion, harmonized rules would have to both reflect a sense of solidarity and prescribe differential treatment. To explain the latter position, *Scholtz* puts on display a wide spectrum of forms of harmonization, some of which are described as being more apt than others to cope with the overriding problem of asymmetry.

Additional problems of harmonizing economic law are revealed in the account *Said Ihrai*[41] gives on the "Harmonization of Business Law in the Maghreb" (p. 399). The Maghreb is a region comprising all the states of West and North Africa bordering the Atlantic and the Mediterranean from Mauritania to Libya. Economic globalization and the establishment of the WTO prompted most states of the Maghreb to liberalize their economies and to do so partly in cooperation, partly in competition with each other. There is, however, a religious dimension to the harmonization of business law in the Maghreb. In addition to social, linguistic and even literacy problems, the liberalization of business law has to remain compatible with the religious traditions that are in part

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reactivated by movements eager to "islamize modernity" instead of "modernizing Islam". Despite those obstacles, the larger states of the Maghreb do their best in separating business from religion, in attracting foreign investment through agreeing to investment arbitration and in installing themselves as members of the WTO. Under a newly established umbrella of protection of foreign investments, devices of private-public and domestic-foreign cooperation are combined by increasingly outsourcing utility functions to joint ventures with foreign investors.

C. Tentative Conclusions

In the following, it is proposed to draw some tentative conclusions. Those conclusions are more in the nature of hypotheses than of theses. Some of them can be backed with references to factual elements or theoretical insights contained in the papers collected in this volume. Where this is the case, the name of the respective author or authors is added in brackets. However grateful this author is for those suggestions, the responsibility for erroneous interpretations and extrapolations, or unintentional omissions, lies with him.

The discussion begins with a look at the driving force behind interjurisdictional competition (Section I). It then proceeds to considering a possible need for, and ways of, strengthening interjurisdictional competition (Section II). An attempt to strike a balance between harmonization and interjurisdictional competition is made in Section III.

I. Incentives for Interjurisdictional Competition

According to political choice theory, governments listen to "voice" and react to "exit" *(Behrens)*. In the present context, voice and exit are expected from business. Business has its own peculiar perspective. The localization of its activities is cost driven and/or market driven *(Gründler)*. In the last analysis, it may be just cost-driven. After all, the impact of markets is felt by business as a cost factor, too. The distance between production sites and customers, as well as the service intensity of marketing a particular product, including advertising it in locally targeted media, make up the bulk of distribution expenses. In addition, tariff and/or non-tariff barriers can invite suppliers to adopt strategies of tariff-hopping by installing production or assembly facilities close to their customers. In the latter case, the costs of market access result from the operation of legal rules, some setting up such barriers and others dismantling them, in part or entirely. The expense of market access can also be raised by restrictive practices and hence be lowered by prohibiting those practices through rules of competition law *(Weiss, Weitbrecht)*.

Interjurisdictional competition relates to one of many parameters of the competition of systems. From a business perspective, other factors driving the localization of business activities are of greater importance, such as state aid and public procurement *(Lorenzmeyer & Schmidt, Weiss)* as well as taxation *(Mussler)*. Legal rules, especially those of economic law, are characterized as also-rans given the number of more pressing cost factors on any investor's checklist *(Gründler)*. Among those also-rans, there are, however, differences worth taking note of:

1. Bulk Character of Economic Legislation

Usually it is the aggregate of rules of economic law or rather its overall perception by business that influences the direction business activities are channelled into. Strong players in commercial markets prefer an economic law environment that allows them to exploit their strengths. It usually is an environment shaped by strict competition laws *(Meyersiek)* and effective enforcement facilities *(Meyersiek, Arner)*. Intellectual property right laws, unless below the level of protection required under the TRIPs Agreement, have little impact on the localization of business activities *(Jänich, Niebel)*, while particular litigation venues can affect the legal services industry *(Kather)*. Despite widespread assumptions to the contrary, securities law can contribute to the strengthening of a particular capital market *(Arner)* but, on its own, it is not sufficiently important to trigger escape strategies *(Laby & Broussard, Thelemann)*. Deficiencies can, however, reach a magnitude, e.g. where bribery is inevitable, that qualifies the respective countries as no-go areas for companies determined to comply with their own compliance code *(Joos)*.

2. Targeted Economic Law Making

There are exceptions to such a wholesale approach to interjurisdictional competition. A cost-benefit-analysis can yield more specific results relating to particular fields of economic law in the following cases:

1. Some economic laws are intimately related to particular business activities. Thus, environmental law can impose cost burdens that make the search for an environmental haven worthwhile (*F. Ortino, Scholtz*). Or the political risk can reach such a magnitude that reasonable investors insist on arbitrability under the ICSID Convention, the Energy Charter Treaty and/or a Bilateral Investment Treaty (*Horn*).
2. Some fields of substantive economic law may be individually targeted under most conflict of laws systems, e.g. contract law (*Behrens*) and corporation law (*Behrens, Schanze*). Law firms, giving advice on the top performing laws (the contract laws of England and the state of New York, British company law and Delaware corporation law), are potential beneficiaries (*Behrens, Schanze, Horn*). A caveat has to be added though. The respective legal services industry need not always be located in the territory of the state that adopted the laws. Wall Street law firms, even law firms in other business centres of the United States, can make more money through giving advice on Delaware corporation law than law firms located in Wilmington, the small-town capital of Delaware. Advice on contract law, however, would benefit from local rooting.
3. Expertise in procedural law cannot easily be outsourced from the forum state and therefore also allows for some targeted economic law making (*Buxbaum, Brand*). On the basis of an international convention providing for the mutual recognition and enforcement of judgements, states can equip their courts with procedural and substantive laws so as to qualify them as "magnet courts" (*Brand*). There is a comparable competition between arbitration centres (*Horn*) even though familiarity with the arbitration law of the state at the respective centre is not the main selling point in arbitration business.

II. Strengthening Interjurisdictional Competition

Like competition among business enterprises, interjurisdictional competition needs to be strengthened by resisting the natural trend towards harmonization (*Kerber, Vaubel)*. The extent to which countervailing measures become necessary depends on the degree of harmonization reached already. It differs by the regions of the world.

Apart from federal states, the highest degree of harmonization between independent legislators is certainly reached in the European Union. There, further harmonization may continue to be welcome, not least as a matter of preferred integration strategies (*Edward)*. Yet institutional incentives of centralization (*Vaubel)* as well as member state decision-making oscillating between abusive collusion and unfair competitive practices *(Mussler)* may cause real concern.

By way of contrast, a look at the Maghreb and at Sub-Saharan Africa reveals deficiencies of economic law-making that may only be overcome by soliciting the help of peer states in programs of harmonization. Upgrading the interjurisdictional competition, which is also evolving in those regions, cannot claim priority. In the case of Sub-Saharan Africa, it is the asymmetry between the advanced economy of South Africa and the much less advanced economies of its partner states that commends steps of harmonization (*Scholtz)*. In the absence of such asymmetry in the Maghreb region, the need to cope with traditional and newly reinforced religious constraints warrants a collective effort (*Ihrai)*.

On the global level, as well as on the still less than global level of the WTO, the choice between more harmonization and more competition probably has to be made on a case-by-case basis. In conducting such analysis, considerable differentiation may prove necessary within a particular field of law. Environmental law, for instance, figures as a prime example for market failure (*Behrens)*. The public good "environment" often stretches across state frontiers. To avoid free riding, internationally agreed harmonization imposes itself. Such harmonization, however, can give room for interjurisdictional competition, e.g. by setting minimum standards only or by incorporating market elements into enforcement. Furthermore, it has to be remembered that political organizations, probably like other organizations, suffer from a bias towards centralization. Organizations sometimes try to justify their existence by taking on more functions than they can actually handle. That bias may have to do with career ambitions of stakeholders in such organizations *(Vaubel)*.

To the extent necessary or desirable, how should such strengthening of interjurisdictional competition be brought about? In that context, it may be helpful to distinguish between optimizing the rules of interjurisdictional competition and making more effective use of its tools.

1. Optimizing the Rules

As to the rules on interjurisdictional competition, one will have to distinguish between those of substantive law and those of procedural law.

1. Substantive law may, depending on the field of economic law, set operative rules that need no further implementation. Such rules would clearly be at the expense of interjurisdictional competition. Merely setting a certain minimum or maximum standard, however, would allow for that competition to continue within a narrower framework.

To the extent harmonization proves necessary, setting up a framework of standards would therefore be the preferable way to proceed *(Weiss)*.

Adopting rules of substantive law always implicates a need to delimit their scope of application. A place-of-conduct connecting factor could possibly induce localizing business activities in the respective state whereas, under conditions of worldwide interdependence, effects of business conduct easily cross state borders. Thus they can only be avoided by altogether refraining from further activities in a particular state (*Kerber)*. Connecting factors, however, cannot be freely chosen. If substantive law is to attain objectives that are not shared by neighbouring states, one has to rely on effects as a connecting factor. Taking instead the place of conduct as a connecting factor would allow for easy circumvention.

Undoubtedly, uneven income distribution among, and within, the states of the world presents one of the greatest challenges to be met in the 21st century. Thus it is proposed to constitutionalize social policy on an international level (*Cottier)*. Germany, for the last 60 years subscribing to a notion of social market economy, has tried hard to reconcile economic policy and social policy. It did so, however, without prioritizing either policy in its constitution. The choice of policy therefore always had to be made in the political process on a case-by-case basis. It is highly unlikely that more can be achieved on an international level. Just like freedom and equality, economic policy and social policy condition each other. They are both indispensable. The demarcation line – or rather the many linkages between them – will have to be determined, as in Germany, on a case-by-case basis.

2. Procedural law is at the core of any effort to enhance the rules governing interjurisdictional competition. The main task of procedural law would be to establish a general jurisdictional order in the multilayered system of today's economic law by finding the right mix of elements of centralization and decentralization (*Kerber)*.

   Agreeing on a distribution of enforcement functions among agencies of the same or a different level regarding a clearly defined subject matter (*Polley)* would cause no concern. Providing for the judicial or arbitral settlement of jurisdictional disputes (*Buxbaum, Vaubel)* would, depending on the soundness of the jurisdictional rules to be applied, also be compatible with striking a fair balance between harmonization and interjurisdictional competition.

   On the whole, however, one should continue to allow for some vertical competition for jurisdiction between the various layers of the multilayered system. Economic problems vary and so does their political perception at any given moment (*Edward v. Vaubel)* and all the more so in the course of time. Competition as a process of discovery can contribute to sorting out the rule and the tool functions of economic law by way of trial and error. On the assumption of greater homogeneity, one can be more precise in a regional context. The diversity of the situation of the Maghreb (*Ihrai)* and in Subsaharan Africa (*Scholtz)* in comparison with the one in the European Union, however, clearly counsel against fixing vertical jurisdiction in any larger scope on a worldwide basis.

2. Competing for Better Tools

Competition always is about achieving better results, no matter whether those results are defined for the purposes of a race to the top or a race to the bottom. The issue is contents. The contents of economic law, however, is wide, elusive and volatile (M. *Ortino)*. It cannot be discussed here. What can be discussed is developing methods of improving the contents by making better use of interjurisdictional competition. Spreading the awareness of the ongoing interjurisdictional competition and allowing governmental decision-makers as well as business to monitor its evolution seem of essential importance *(Kerber, Schanze)*. Efforts could be undertaken along the following lines:

1. Yardstick competition would be further strengthened if comparative assessments were made a standard requirement in the law-making process. The transparency of interjurisdictional competition would be increased by gradually adopting a bench marking system. The setting of a bench mark would, of course, have to be followed by verification of its attainment within a clearly defined time limit.
2. Another, though related, way would be for the executive branch of government to commit itself to monitor the performance of competing jurisdictions and to make the results known to a wider public. In addition, one might consider requiring administrative agencies as well as the judiciary to construe legal rules wherever possible with a view to enhancing the overall performance of domestic law in comparison with foreign jurisdictions enforcing like legislation under like conditions.

It would be for academia to prepare the ground for the above policy proposals. Lawyers generally know little about the results of economic legislation, neither beforehand, nor in retrospect. Once agreement has been reached on how to establish such a "rating system" (*Schanze)*, its parameters can be used to develop comparative synopses allowing the legislative branch and enforcement agencies as well as business and the public at large to compare the contents and the performance of existing laws in various jurisdictions. First steps in that direction have already been undertaken by the international competition network, whose members regularly produce and publish so-called templates comparing, for instance, merger control laws. Surely, such practice could be further developed and extended to other fields of economic legislation.

III. Openness of Competition versus Top-Down-Constitutionalism

Perhaps the greatest challenge advanced against interjurisdictional competition in economic law is to resort to a comprehensive constitution of global coverage (*Cottier)*. Searching for a lasting combination of harmonization and decentralization (*Kerber)* follows halfway and also reveals considerable confidence in international rule-making. Suggesting globalized rule-making in competition law as a ready response to incomplete convergence (*Lorenzmeyer/Schmidt)* points in that direction as well.

A slogan like "The global economy needs global law" fits into any politician's mind, and yet it is plain wrong. To begin with, there is no global economy, and hopefully there will never be one. The economy is run by an infinite number of business enterprises. Many of them operate globally, trying to meet most diversified demands by offering most diversified goods and services all over the globe. That diversity has to be, and is at present,

matched by rules of economic law providing business with some order trying to keep pace with constantly changing conditions in globalized or globalizing markets *(Schanze)*.

To be sure, business suffers from and complains about the simultaneous applicability of a multitude of – occasionally even contradicting – demands of economic law. Many of those laws are unnecessarily complicated. Some are just unnecessary. Unnecessary transaction costs are bound to arise in both cases. But does that necessarily require an attempt at lowering transaction costs by adopting global rules of law on each and every subject matter?

1. The transaction costs of operating under uniform global rules may be lower in terms of expenses to be met by business. But they are bound to be higher, at least after a while, in terms of adequately solving the legislative problems to be solved. No globally applicable rule of law can ever be commensurate with any particular problem arising at different places in different circumstances. In fact, global rules are likely to reflect a kind of worldwide average that falls short of an ideal solution at any place of the world.
2. As long as sovereign – in political science jargon "Westphalian" – states are still around, rules of worldwide obligatory force have to be voluntarily agreed upon by multilateral treaties. The difficulties of first agreeing on anything meaningful and then making the respective international instrument enter into force are commonplace. Well, one could try hard. But once one has, against all the odds, come to a meaningful agreement, it is even more difficult to amend that agreement. Amendments, however, may become necessary as a result of changing conditions, changing perceptions and/or changing political aspirations. Given that prospect, investing political capital into forging global rules needs to be reconsidered. Otherwise, there is a definite risk of the world getting stuck with global economic laws that stifle economic development and – raise transaction costs.

Instead of taking top-down decisions on the international level, it is preferable as Hayek would put it, to steer clear of any "pretence of knowledge" and trust the "discovery process" of interjurisdictional competition. The states and supranational organizations as players in that market will adopt economic laws under the trial-and-error principle. They will themselves bear the chances of success and the risks of failure. Constantly checking the results of economic legislation, they can observe how their peers are performing and thus remain ready to adjust their laws to new needs and new insights. In short, this author repeats his competition of competition laws plea[42] and postulates its potential applicability to every field of economic law.

The trade law community has shown itself reluctant to take up that suggestion. Partly that is due to vested interests directly or indirectly tied to international organizations that try to promote their agenda. But there is also a serious argument, which needs to be addressed:

Trade issues are described as being too complex for voters to understand. Accordingly, voters fall victim to interest groups that pursue their special interests by lobbying for protectionist measures harmful to the economy as a whole. That unfortunate situation, so the argument continues, can only be remedied by relying on the benign effects expected to flow from rules of international law or from binding decisions taken by international

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[42] Meessen, *Competition of Competition Laws*, 10 Northwestern J. Int'l L. & Bus. 17 (1989).

organizations. Such rules or decisions shield governments against the risk of losing the next election when they dare fend off special interests (*Cottier, Vanberg)*.

The argument may not be overly democratic but the assessment of the political economics of domestic trade policy it contains is quite realistic. In the end, one will therefore have to weigh the strength of that argument against the welfare effects of interjurisdictional competition in a case-by-case analysis. In doing so, however, one should not regard the present weakness of interjurisdictional competition in domestic trade politics as permanently given. Interjurisdictional competition may be stimulated. It can be stimulated to such an extent that the voters, who ultimately have to strike the balance between harmonization and continuing interjurisdictional competition, become responsive to pieces of information like: neighbouring country X benefits from particular rules of economic law that result in higher yields and/or lower costs, hence let us move into a similar direction or try to do even better.

At present, comparative arguments are common in so far as they relate to comparing gross national product and unemployment figures. Those figures represent the bottom-line without, however, giving a clue as to the reasons of diverging performance. Interjurisdictional competition in economic law could do that. It could operate as an early warning system, e.g. by regularly publishing comparative economic impact assessments with regard to particular pieces of legislation. Why should voters accept suboptimal economic legislation where that legislation is bound to eventually contribute to a loss of national income and/or to higher unemployment figures?

If the above, or other, proposals designed to enhance the transparency of interjurisdictional competition are put in place, comparative argument can build up competitive pressure on governments. It can produce more political clout than binding obligations of international law, behind which governments love to hide even though they themselves signed them into law. Thus interjurisdictional competition can develop its bottom-up discovery functions and, at the same time, allow voters to retain democratic control of the decision-making process. On the whole therefore, interjurisdictional competition should be preferred to top-down constitutionalism. Yet it needs invigorating.[43]

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[43] For further reflections on the subject see my paper on "Prinzip Wettbewerb" scheduled for publication in JuristenZeitung in July 2009.

Part I
Theoretical Considerations

The Theory of Regulatory Competition and Competition Law

Wolfgang Kerber[*]

A. Introduction

The question of the governance of competition on global markets is on the international agenda since the 1990s.[1] The soaring emergence of world-wide mergers and the detection of a number of international cartels have demonstrated the relevance of global restraints of competition. It also questioned the effectiveness of the traditional approach of protecting competition through an extraterritorial application of domestic competition law ("effects doctrine"). Within the EU the efforts for integrating European markets were complemented by the systematic expansion (and supremacy) of the supranational European competition law. Whereas the initiatives for introducing global competition rules (eg, within the WTO) failed, the International Competition Network (ICN) as a voluntary network of national competition authorities with the aim of exchanging information and identifying and spreading knowledge about best practices how to combat anticompetitive behaviour is thriving. Parallel to this development in competition law, we have a very intensive discussion on the merits and deficits of regulatory competition, i.e. competition between legal rules and regulations. Beginning with the discussion about competition among corporate laws in the U.S., the question of regulatory competition vs. harmonisation is a recurrent hot topic both within the European integration process and on the level of global integration. So far the research about regulatory competition shows that the question about the benefits and problems of regulatory competition depends crucially on the kind of legal rules and regulations, and is closely intertwined with the general analysis of the advantages and disadvantages of centralisation (harmonisation) and decentralisation of rules in a multi-level legal system.

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[1] See generally F. M. Scherer, *Competition Policies for an Integrated World* (Washington 1994); W. Fikentscher and U. Immenga (eds.), *Draft International Antitrust Code* (Nomos, Baden-Baden 1995); J. Basedow, *Weltkartellrecht: Ausgangslage und Ziele, Methoden und Grenzen der internationalen Vereinheitlichung des Rechts der Wettbewerbsbeschränkungen* (Mohr Siebeck, Tübingen 1998); K. Meessen, *Das Für und Wider eines Weltkartellrechts* (2000) 50 Wirtschaft und Wettbewerb 5; J. Drexl (ed.), *The Future of Transnational Antitrust – From Comparative to Common Competition Law* (Stämpfli/Kluwer, Bern/Den Hague 2003); F. Jenny, *International Cooperation on Competition: Myth, Reality, and Perspective* (2003) 48 Antitrust Bulletin 973; M. Janow and C. R. Lewis, *International Antitrust and Global Economy* (2001) 24 World Competition 3; R. A. Epstein and M. S. Greve (eds.), *Competition Laws in Conflict: Antitrust Jurisdiction in the Global Economy* (AEI Press, Washington 2004); O. Budzinski, *The Governance of Global Competition. Competence Allocation in International Competition Policy* (Edward Elgar, Cheltenham 2008).

The aim of this contribution is a brief analysis whether, to what extent and how regulatory competition might also be a successful concept that can be applied to competition law, and what policy conclusions can be drawn for the global governance of competition. In section B we will give a brief overview about the most important results of the general research about regulatory competition within a multi-level legal system. The main analysis about the possibility of regulatory competition in competition law will be carried out in section C. Although our results will suggest a strong reluctance in regard of using the mechanism of regulatory competition for competition laws, section D will demonstrate that this does not exclude the recommendation of a fairly decentralised global multi-level system of competition laws. One of the main arguments will be that decentralised experimentation and mutual learning might considerably support the long-term evolution of effective competition law regimes. From that theoretical perspective some conclusions are drawn for the efforts of the International Competition Network (ICN) in the concluding section E.

B. Regulatory Competition and Multi-Level Legal Systems: A Theoretical Framework

The member states of the EU, the EU and the global level can be viewed as three tiers of a multi-level system of jurisdictions. From a theoretical perspective, substantial rules (as competition law), enforcement agencies (as competition authorities) and courts can exist on each level of such a multi-level legal system. One crucial problem is the vertical allocation of competences within such a system, which requires vertical competence allocation (and delimitation) rules. The example of competition law in Europe (and in the U.S.) demonstrates that the vertical allocation of competences can be different in regard to substantial rules, competition authorities, and courts. A precondition for regulatory competition is that the system is not entirely centralised (or harmonised), i.e. that a significant amount of decentralisation is maintained. However, even in a fairly decentralised multi-level legal system the possibility and extent of regulatory competition also depends on the mobility of firms and goods (and services) between jurisdictions or on the extent legal rules of different legal systems can be chosen directly by private parties. This implies that legal rules about the mobility of firms, persons, production factors, goods and services as well as rules about choice of law and conflicts of law are relevant – both for the possible extent of regulatory competition and for the working properties of the entire multi-level legal system. From an economic perspective the question can be raised what the optimal structure of a multi-level legal system is, which would encompass the questions for the optimal vertical allocation of competences, for the optimal extent of regulatory competition, and for the appropriate set of rules for the governance of the multi-level legal system. The economic theory of legal federalism can provide some insights about the appropriate design of such a multi-level legal system.

The economic theories of federalism and interjurisdictional/regulatory competition can provide a number of (theoretically and empirically well-founded) criteria for decisions on the optimal degree of centralisation or decentralisation.[2] Therefore the following

[2] For overviews on the economic theory of federalism, interjurisdictional competition, and legal federalism see C. M. Tiebout, *A Pure Theory of Local Expenditures*, 88 Journal of Political Econ-

criteria can also be viewed as criteria for applying the subsidiarity principle. Cost criteria (e.g., economies of scale, information and transaction costs, barriers of trade) often lead to arguments in favour of more centralisation and harmonisation. Decentralised multi-level legal systems can also suffer from cross-border externalities and conflicts between different legal rules, which are particularly important in the case of cross-border restraints of competition and the application of competition law. Heterogeneous preferences of the citizens and different problems in lower-level jurisdictions usually suggest a larger degree of decentralisation. This is also true for arguments that emphasize our limited knowledge about the appropriate legal solutions, because in a decentralised system more knowledge (and innovations) can be generated through parallel experimentation and mutual learning (laboratory federalism). Other relevant criteria are political economy arguments and path dependence effects, which both can lead to arguments for more centralisation or decentralisation, although many stress the dangers of centralisation from a political economy perspective. Beyond these criteria derived from allocative efficiency, also distributional criteria and other values as individual freedom can be taken into account. One important criterion is also whether any regulatory competition processes that might emerge in a decentralised legal system will have more beneficial than harmful effects. The application of such a set of economic criteria to different fields of the law usually leads to a broad variety of results. The research so far suggests that the optimal solutions are rarely the extreme solutions of fully centralised or decentralised systems. The most promising institutional solutions often seem to be sophisticated combinations of centralised and decentralised rules, with a certain extent and type of regulatory competition.[3]

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omy 247; W. E. Oates, *An Essay on Fiscal Federalism* (1999) 37 Journal of Economic Literature 1120; V. Vanberg and W. Kerber, *Institutional Competition Among Jurisdictions: An Evolutionary Approach* (1994) 10 Constitutional Political Economy 219; F. H. Easterbrook, *Federalism and European Business Law* (1994) 14 International Review of Law and Economics 125; W. W. Bratton and J. A. McCahery, *The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World* (1997) 86 The Georgetown Law Journal 201; D. C. Esty and D. Geradin (eds.), *Regulatory Competition and Economic Integration. Comparative Perspectives* (Oxford University Press, Oxford 2001); A. Marciano and J. M. Josselin (eds.), *From Economic to Legal Competition. New Perspectives on Law and Institutions in Europe* (Edward Elgar, Cheltenham 2003); for lists of economic criteria for the optimal vertical allocation of competences see R. J. Van den Bergh, *Economic Criteria for Applying the Subsidiarity Principle in the European Community: The Case of Competition Policy* (1996) 16 International Review of Law and Economics 363; W. Kerber and K. Heine, *Zur Gestaltung von Mehr-Ebenen-Rechtssystemen aus ökonomischer Sicht*, in C. Ott and H. B. Schäfer (eds.) *Vereinheitlichung und Diversität des Zivilrechts in transnationalen Wirtschaftsräumen* (Mohr Siebeck, Tübingen 2002); W. Kerber, *European System of Private Laws: An Economic Perspective*, in F. Cafaggi and H. Muir Watt (eds.), *The Making of European Law* (Edward Elgar, Cheltenham 2008).

3 For a specific application on contract law within the EU see W. Kerber and S. Grundmann, *An Optional European Contract Law Code: Advantages and Disadvantages* (2006) 21 European Journal of Law and Economics 215; for a broad application to a wide set of different economic policies in the EU see K. Heine and W. Kerber (eds.), *Zentralität und Dezentralität von Regulierung in Europa* (Lucius & Lucius, Stuttgart 2007).

Since the beginning of the 1990s a broad theoretical and empirical literature emerged on the merits and problems of regulatory competition.[4] Starting with the much older controversy about the workability of regulatory competition between the corporate laws of the federal states in the U.S., this discussion primarily has focussed on the question whether regulatory competition would lead to a beneficial (welfare-increasing) improvement or deterioration of legal rules and regulations ("race to the top" vs. "race to the bottom"). The most important arguments in favour of regulatory competition are that it would lead (1) to more efficient legal rules and regulations (in regard to their costs and their fulfilment of citizens' preferences), (2) to more innovative improvements and faster adaptation of legal rules to new problems and circumstances (including a faster correction of erroneous solutions), and (3) to smaller welfare losses due to rent-seeking activities, because the losers in the rent-seeking game have the exit option. However, also a number of sound arguments supporting a critical stance on regulatory competition have been raised: Through regulatory competition (1) mandatory regulations can be circumvented, (2) too high information and transaction costs might ensue, (3) politicians might not have appropriate incentives for improving legal rules. Particularly prominent is the argument that (4) regulatory competition might imply competition for ever lower standards, with the result of inefficiently low regulatory standards (race to the bottom). A much more recent but very relevant second discussion refers to the question whether despite the existence of important preconditions as mobility/choice of law (and "mutual recognition" in the case of regulations) regulatory competition in the sense of dynamic rivalrous processes does emerge at all.

The most important result of the research on the advantages and problems of regulatory competition is the necessity for differentiation. General conclusions about the question whether regulatory competition is mostly beneficial or harmful are not possible. It depends crucially on the kind of regulation and the field of the law, on a number of specific circumstances and on the set of rules governing regulatory competition, whether and to what extent regulatory competition can be recommended or should be avoided, eg, by limiting mobility/choice of law or by centralisation or harmonisation of these legal rules. In regard to the kind of regulation, it can be hypothesized that regulations that primarily protect third parties' interests might be less suitable for regulatory competition than legal rules that mostly intend to reduce transaction costs for private parties (as, eg, facilitative contract law rules), because the incentives for race to the bottom processes might be much smaller (or even non-existent) in the latter case than in the former one.

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4 See H. Siebert and M. J. Koop, *Institutional Competition. A Concept for Europe?*, 45 Aussenwirtschaft 439; R. L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race to the Bottom" Rationale for Federal Environmental Regulation* (1992) New York University Law Review 1210; J. M. Sun and J. Pelkmans, *Regulatory Competition in the Single Market* (1995) 33 Journal of Common Market Studies 67; H. W. Sinn, *The Selection Principle and Market Failure in Systems Competition* (1997) 88 Journal of Public Economics 247; A. Ogus, *Competition between National Legal Systems: A Contribution of Economic Analysis to Comparative Law* (1999) 48 International and Comparative Law Quarterly 405; R. J. Van den Bergh, *Towards an Institutional Legal Framework for Regulatory Competition in Europe* (2000) 53 Kyklos 435; J. P. Trachtman, *Regulatory Competition and Regulatory Jurisdiction* (2000) 3 Journal of International Economic Law 331; K. Heine and W. Kerber, *European Corporate Laws, Regulatory Competition and Path Dependence* (2002) 13 European Journal of Law and Economics 43; Esty/Geradin (n. 2); Marciano/Josselin (n. 2); Kerber, 2008 (n. 2).

However, an overall assessment of all positive and negative effects of a specific case of regulatory competition can lead to a different outcome. Since a correct analysis always requires the comparison with alternative institutional arrangements (comparative institutional analysis), it is also necessary to analyse the effects of regulatory competition as part of the whole multi-level legal system, i.e. that also the above-mentioned advantages and disadvantages of centralisation and decentralisation have to be taken into account (eg, the costs of the elimination of regulatory competition through disadvantages of centralisation or harmonisation).

One often neglected additional reason for differentiation is the necessity to take into account that also different types of regulatory competition must be distinguished. For example, the type of regulatory competition which ensues in the market for corporate laws in the U.S. (through the right to incorporate in any state) differs very much from regulatory competition in regard to environmental laws which might follow from the mobility of capital between different jurisdictions (interjurisdictional competition) or from competition between national product regulations as a result of the introduction of the principle of mutual recognition within the EU. Depending on the extent of mobility four main types of regulatory competition can be distinguished:[5]

- Direct regulatory competition through choice of law (mobility of legal rules)
- Direct regulatory competition through interjurisdictional competition (mobility of firms, persons, and capital)
- Indirect regulatory competition through international trade (mobility of goods)
- Indirect regulatory competition through yardstick competition (mobility of information)

These different types of regulatory competition have very different incentive structures for the jurisdictions as suppliers of legal rules and for the firms as the users on the demand side. Therefore competition works very differently and can lead to a wide variety of outcomes. This implies that for some fields of the law one type of regulatory competition might lead to predominantly positive results, whereas other types should be avoided. As a consequence, also the type of regulatory competition is important for any policy recommendations; and through decisions about rules for mobility and choice (and conflict) of law rules, different types of regulatory competition can be implemented or eliminated.

C. The Limited Scope for Competition of Competition Laws

Should we strive for a centralised (or harmonised) competition law on the global level in order to improve the fighting of international restraints of competition or would a more decentralised system of competition laws with some form of competition of competition laws be more preferable? In this section, we want to analyse the effects of competition of competition laws. We will apply our differentiation of four different types of regulatory competition for analyzing more precisely what competition of competition laws might

[5] For this differentiation see W. Kerber and O. Budzinski, *Towards a Differentiated Analysis of Competition of Competition Laws* (2003) 1 Journal of Competition Law (ZWeR) 411; K. Heine, *Regulierungswettbewerb im Gesellschaftsrecht. Zur Funktionsfähigkeit eines Wettbewerbs der Rechtsordnungen im europäischen Gesellschaftsrecht* (Duncker & Humblot, Berlin 2003).

mean and what the probable effects of each of these different types would be if applied to competition law.[6] Although these analyses will be made on a purely theoretical level, two remarks about the real conditions should precede: Since on the global level competition laws are not centralised or harmonised, one precondition for regulatory competition is given. However, the impact of the "effects doctrine" as a wide-spread conflict of laws rule in competition law will be discussed only after the theoretical analyses of these four types.

I. Regulatory Competition Through Choice of Law

This is the type of regulatory competition that is meant in the U.S. discussion about competition between corporate laws and which, in the meantime, is assessed positively by most scholars. In regard to competition law, this would mean that the firms would have the right to choose themselves the competition law regime (without having to migrate to this country) that controls their behaviour in regard to restraints of competition. The results of such a free choice of competition law are not hard to predict. Merging firms or firms seeking cartel exemptions would choose the competition law regimes that would grant them the permission most easily. Free choice of law would lead to a circumvention of competition laws. To some extent, the discussions about forum shopping in competition law reflect this concern. Whether free choice of competition laws would also lead to "race to the bottom" in the sense of a dynamic process of deteriorating competition laws would depend on the specific incentive structures for governments in attracting users for their competition law. Theoretically, there might also be two kinds of positive effects: Such a regulatory competition could induce jurisdictions to make their competition laws more cost-effective (without deteriorating the protection level). Positive effects might also accrue in the possibly not rare case of an over-regulated competition law. However, only in exceptional cases might these positive effects outbalance the negative ones that can be expected. As a consequence, this type of regulatory competition, which seems to do well in U.S. corporate law and in non-mandatory contract law, cannot be recommended for competition law.

II. Regulatory Competition Through Interjurisdictional Competition

Even without free choice of law, firms and production factors might be able to choose their legal system directly through relocating to other jurisdictions (mobility of firms, persons, and production factors). This can lead to incentives for jurisdictions to offer attractive bundles of public goods and services (including legal systems) and taxes in order to induce the influx of firms and investments. In the theory of interjurisdictional competition there has been a long discussion about the potential advantages and problems

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[6] The following analysis can be found in much more detail and with more references in Kerber/Budzinski (n. 5); W. Kerber and O. Budzinski, *Competition of Competition Laws: Mission Impossible?*, in R. Epstein and M. S. Greve (eds.), *Competition Laws in Conflict. Antitrust Jurisdiction in the Global Economy* (AEI Press, Washington, D.C. 2004); for earlier discussions of competition of competition laws see K. M. Meessen, *Competition of Competition Laws* (1989) 10 Northwestern Journal of International Law and Business 17; P. Nicolaidis, *Competition Among Rules* (1992) 16 World Competition 113; R. Van den Bergh (1996) (n. 2).

of this kind of competition (eg, tax competition). Since competition law is a (small) part of the legal system, it might also be used for improving the attractiveness of a jurisdiction as a location. Therefore regulatory competition in competition law can be part of interjurisdictional competition. This also suggests a first problem: Competition law might not be important enough to have a large impact on locational decisions; but that might be different in special cases. Secondly, on the theoretical level it is not clear whether firms would prefer an effective competition law or very lax competition rules. On first sight, it seems that firms might not want to be monitored critically in regard to their anticompetitive behaviour. However, firms might also be interested in being protected against anticompetitive behaviour of other firms. If in a country price-fixing behaviour and the use of market power by dominant firms is wide-spread (due to an ineffective competition law regime), then also input prices and production costs are higher. From that perspective, it can be a prudent strategy for a jurisdiction to develop an effective competition law – also under the conditions of jurisdictional competition. This opens up the possibility of an improvement of competition laws through interjurisdictional competition (race to the top). However, firms might also be attracted by a competition law that does not restrict their freedom to cartelise and merge. Then interjurisdictional competition can induce problematic strategic competition policies.

The following strategic competition policies can be distinguished:

(1) Helping to get market power on international markets: A jurisdiction might offer a generous merger control that enables firms to gain more easily market power on international markets. Although it usually will also harm domestic consumers, on balance it can lead to a rent-shifting from other countries into the domestic jurisdiction. Another example are exemptions for export cartels. Since it implies a redistribution of welfare from other countries, it is an example of a beggar-my-neighbour policy.

(2) Using domestic market power for cross-subsidizing predatory behaviour on international markets: Another variant with similar negative welfare effects on other countries can be to allow firms to get market power on domestic markets that allows them to finance predatory behaviour on international markets. Therefore competition law can promote dumping strategies.

(3) Allowing efficiency-enhancing mergers for improving international competitiveness despite the emergence of domestic market power: This is a very different case, because here even global total welfare might increase. This might lead to an international competitiveness defence that even might be accepted under a global consumer welfare standard. The problem is that the domestic consumers are not protected through domestic competition law.

(4) Allowing domestic market power without international effects: In interjurisdictional competition, a jurisdiction might also attract foreign firms by offering the possibility to make profits through market power in domestic markets. This can be a substitute for tax exemptions or the direct payment of subsidies in locational competition.

It would not be hard to find examples for all of these strategic competition policies. However, it is less clear to what extent these strategies have been used primarily for attracting firms in interjurisdictional competition (except the last one) or whether they have been predominantly instrumental for supporting domestic firms on international markets, as it is shown in our next type of competition of competition laws.

What conclusions can we draw in regard to the effects of this type of competition of competition laws? Whether firms prefer an effective or an ineffective competition law

might also depend on the industries and seems to be a primarily empirical question. There are industries, which are very sensitive to competition law (eg, industries with homogeneous products are very prone to price collusion) and others, which are less so. As far as a less restrictive competition law is attractive (which often means less or very selective enforcement instead of generally lax rules), interjurisdictional competition might lead to those strategic competition policies and therefore to a deterioration of the protection of competition. This can also be seen as an international prisoners' dilemma problem: All countries might be able to increase their welfare, if no country would embark on these strategic competition policies. However, each country would have an individual incentive to increase its own welfare by choosing those strategies.[7] Since interjurisdictional competition, however, can also improve the protection of competition, this type of competition of competition laws should not be rejected generally. Rather it might be worthwhile to search for rules that would allow discouraging these problematic strategic competition policies without eliminating this type of competition of competition laws altogether.

III. Indirect Regulatory Competition Through International Trade

Regulatory competition can also work, if the firms are not able to choose directly between legal rules or regulations (either by choice of law or by relocation). In contrast to the last section, it can also be assumed that the firms and production factors are immobile between countries but compete with each other on international markets. Mobility of goods and immobility of production factors are the core assumptions of traditional economic theories of international trade. If domestic firms produce under more efficient legal rules than their foreign competitors, then their production costs are lower, leading to a competitive advantage and to more (or better paid) jobs in the export industry. Therefore an indirect form of competition between the regulations of different countries exists, at least as far as the firms compete on international markets. The mechanisms of regulatory competition, however, are different. It might be in the interest of all citizens that the international competitiveness of the domestic firms is increased, but it can also be suggested that the domestic producers would lobby for changing legal rules and regulations for improving their position on international markets. This leads directly to well-known industrial policy arguments, which have played a large role in competition policy for a long time. They lead to rather similar strategic competition policies that have been described in the last section – but for promoting domestic firms instead of attracting new firms into the jurisdiction.

What are the specific forms, in which these kinds of strategic competition policies can influence the application of competition law? Most important are generous exemptions from merger control and the prohibition of cartels in order to make domestic firms (as national champions) more competitive on international markets. Especially exemptions for R&D joint ventures are a popular instrument. For example, both the U.S. antitrust policy and the EU competition policy have explicitly used this argument of promotion of international competitiveness for arguing in favour of less restrictive rules for

[7] Please note that this is only true for a one-shot game. The argumentation is also less clear in regard to the strategic competition policies (3) and even (4). More literature on other aspects of strategic competition policies can be found in Budzinski (n. 1), 53-64.

exempting R&D cooperations, even of big firms with large market shares. In regard to industrial policy, also the problem of rent seeking activities must be emphasized. Even if such a strategic competition policy is not welfare-increasing for a jurisdiction, it cannot be excluded that lobbying activities of certain industries succeed in implementing such strategic competition policies. This often leads to redistributions from domestic consumers to domestic producers through market power, whose prevention is sacrificed for alleged positive welfare effects through more international competitiveness. This political economy problem is much more serious in this case of regulatory competition than in the case of interjurisdictional competition, because well-established domestic industries have more possibilities for successful rent seeking. From the example of strategic trade policies we know that those strategic beggar-my-neighbour policies can induce other countries to respond with similar strategies, leading again to international prisoners' dilemma situations. Therefore also regulatory competition through international trade can lead to a dynamics of deteriorating the protection of competition. If, however, this danger of strategic competition policies can be contained through appropriate rules, then the incentives through the indirect mechanism of competition on international markets can induce the governments of the jurisdictions to improve their competition law regimes, because competitive domestic markets can be the best instrument for making domestic firms more competitive.

IV. Indirect Regulatory Competition Through Yardstick Competition

One interpretation of competition of competition laws is based upon the argument that in a decentralised system jurisdictions can improve their competition law regimes by learning from the experiences of others. This is also the basic idea of "laboratory federalism", which emphasizes the advantages of decentralised experimentation in a federal system.[8] A deeper theoretical analysis can link this interpretation with evolutionary concepts of competition, which views competition (along Hayek's concept of competition as a discovery process) as a process of parallel experimentation with different competition law regimes, from which the jurisdictions can learn mutually. An important epistemological starting-point is Hayek's insight in our limited knowledge about the optimal legal rules, i.e. this approach emphasizes that we neither have already the knowledge about the best competition law regime nor can expect that so far reliable competition rules might also be the best in future (due to non-predictable economic and technological change). From such an evolutionary perspective, it is necessary that also competition law regimes must be innovative and adaptable. It should be borne in mind that a competition law regime consists of a large number of legal instruments, as, eg, substantial legal rules, procedural rules, the institutional structure of competition authorities, and a number of technical and empirical methods for the application of competition law (calculation of turnovers, definition of markets etc.), which still can and should be improved. The same is true for our limited knowledge in economics about the effects of business behaviour

[8] See, e.g., Oates (n. 2); K. Kollman and others, *Decentralization and the search for policy solutions* (2000) 16 Journal of Law, Economics, and Organization 102; W. Kerber, *Applying Evolutionary Economics to Public Policy: The Example of Competitive Federalism in the EU*, in K. Dopfer (ed.), *Economics, Evolution, and the State: The Governance of Complexity* (Edward Elgar, Cheltenham 2005).

and of changes of market structures. Parallel experimentation with different new problem solutions for fighting against restraints of competition can be a powerful mechanism for improving our knowledge about effective competition law regimes.

Of course, this dimension of competition as a process of experimentation and mutual learning is also an inherent part of all the other types of competition of competition laws treated above. However, this type of regulatory competition does only consist of this mechanism of parallel experimentation and mutual learning. Therefore it can also work in those cases, in which there is neither choice of law nor the mobility of firms, production factors or goods and services between the jurisdictions. The only precondition is the mobility of information, i.e. that the jurisdictions can observe mutually their policies and the resulting outcomes. In the history of competition policy many examples for learning from other competition law regimes can be found. Most obvious is the pioneering role of U.S. antitrust law, from which other competition laws have learnt and imitated (selectively) for decades. European competition law has learnt much from German competition law up to the end of the 1980s, whereas since the 1990s the main direction of learning has been from the European level to the competition law regimes of the Member States. It is especially important to see that these learning processes are often very specific, i.e. they can refer to specific legal rules, methods, theoretical arguments or even institutional structures. In section E, we will see that also the International Competition Network is focussing on this aspect of mutual learning.

What can be the transmission mechanism for this type of regulatory competition? In the economic theory of federalism this type is also well-known as yardstick competition. One mechanism is based upon intrajurisdictional political competition. It is assumed that the citizens do not have the knowledge to assess the performance of their government; then the voters in a general election use the performance of the governments in other jurisdictions (eg, unemployment rates, taxes) as a yardstick to measure the performance of their own government. Therefore the information about the policies and their outcome in other jurisdictions can be the basis for decisions about reelection, but the governments themselves can use that information to improve their policies in order to increase their chances for staying in power. However, intrajurisdictional political competition need not be the only transmission mechanism. Another important mechanism is academic discussion. For example, in comparative law the effectiveness of different legal solutions in different jurisdictions for similar problems are discussed and compared. Within the academic system scientific progress can itself be interpreted as the outcome of a competitive process between different scientific theories and methods, driven by competition for reputation and resources for research. Therefore the academic discussion within the international community of economic and legal competition experts (economists, lawyers, and practitioners) is itself a mechanism for experimentation with new theories and methods and mutual learning. The exchange of experiences between competition authorities (as it is organized within the International Competition Network) can be seen as part of this process.

How well can this type of regulatory competition work? Learning from the experiences of others can be a very valuable form of improving our knowledge about appropriate policies. Within the EU, the "Open Method of Co-ordination" was introduced as a governance method for exploiting this chance of learning from the diverse experiences with the policies of the Member States. However, there are also a number of problems

that should not be ignored.[9] Learning from the experiences and policies of other competition law regimes requires that the objectives and competition problems do not differ too much. It is also possible that jurisdictions (and even experts) are not capable to identify the best solutions, leading to the learning of erroneous solutions from others. More worrisome is that the imitation of wrong policies can also be the result of intrajurisdictional rent seeking activities or of problematic race to the bottom processes (but only in the cases of deficient interjurisdictional competition or industrial policies for promoting international competitiveness). However, if these problems of strategic competition policies can be avoided through appropriate rules, then competition of competition laws as a process of parallel experimentation and mutual learning can contribute much to the long-term evolution of effective competition law regimes, because it promotes their adaptability and innovativeness.

V. Competition of Competition Laws: Summarizing the Results

These analyses have demonstrated clearly that competition of competition laws can be understood very differently. Using our differentiation of four main types of regulatory competition, it has been shown that these types of competition of competition laws have to be assessed very differently. Especially important is that the most propagated type of regulatory competition through free choice of law is nearly always entirely inappropriate for competition law due to circumvention problems. In the cases of direct regulatory competition through interjurisdictional competition and indirect regulatory competition through international trade competition of competition laws might work and lead to a process of improving the effectiveness of the protection of competition. However, also negative welfare effects can dominate, if the jurisdictions pursue strategic competition policies in form of reducing the enforcement of competition laws in order to attract new firms to the jurisdiction or make domestic firms more competitive on international markets. These strategic competition policies would lead to negative externalities for other countries and a too low protection of competition on international markets (reducing global welfare). If such strategic competition policies can be avoided through appropriate rules, then these types of competition of competition laws might have more positive than negative welfare effects. Only the last type of regulatory competition, which focuses on the pure knowledge-generating effect through parallel experimentation and mutual learning, does not have systematic defects as, eg, race to the bottom problems. Although this type of competition of competition laws might also suffer from minor problems, it can be expected to contribute to the long-term evolution of effective competition law regimes.

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[9] See eg J. Arrowsmith, K. Sisson and P. Marginson, *What Can "Benchmarking" Offer the Open Method of Co-ordination* (2004) 11 Journal of European Public Policy 311.

VI. The Impact of the Effects Doctrine

Most competition laws apply the effects doctrine, i.e. they claim jurisdiction over all restraints of competition (wherever they take place), as long as they have anticompetitive effects on their respective domestic markets. This does not only imply the possibility of an extraterritorial application of competition law but also leads to a cumulation of applicable competition laws to one competition case. To what extent are the different types of competition of competition laws possible under the effects doctrine as conflict of law rule? If a firm wants to sell its product within a certain jurisdiction, then this firm has to comply with the competition laws of this jurisdiction. The effects doctrine does not only exclude free choice of competition laws, also interjurisdictional relocations do not help avoid the application of domestic competition laws, as long as the firms do not want to give up this market. Therefore the effects doctrine renders regulatory competition by choice of law impossible. In regard to regulatory competition via interjurisdictional competition and international trade, a differentiated answer must be given. As long as the foreign competition laws have a higher level of protection than the domestic competition law, regulatory competition is possible. However, if other countries embark on strategic competition policies with negative externalities, the effects doctrine can be used to stop such a behaviour through extraterritorial application of the domestic competition law. The effects doctrine is certainly no impediment for regulatory competition through parallel experimentation and mutual learning, although the resulting variety of competition laws can lead to serious problems, because other countries might have different opinions about the necessary level of protection. From that perspective, the effects doctrine can be seen as an instrument for stopping some problematic forms of competition of competition laws while allowing other more beneficial ones.

However, the effects doctrine is a rather blunt and often ineffective instrument, with which the countries try to defend themselves against restraints of competition carried out in other countries. The main problem is well-known: The extraterritorial application of domestic competition law is often not enforceable; and as far as the effects doctrine cannot be enforced, it can also be no instrument against the problematic effects of circumvention and strategic competition policies. The problem of enforceability also leads to asymmetries, because the EU and the U.S. are much more capable to enforce their competition laws extraterritorially than smaller industrialised countries or even developing countries. In the meantime, also another group of problems is known very well: The effects doctrine can lead to plenty of conflicts between competition laws (through the cumulation of reviews, eg, in merger cases), and to excessive direct administrative and legal costs and indirect costs through delays and complicated compromises (remedies).[10] Therefore the effects doctrine does not seem to be the optimal rule for dealing with these problems.[11] This leads us back to the problem how the whole multi-level system of competition laws should look like.

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[10] See for the problems of the effects doctrine Budzinski (n. 1), 32-49, 168-173.

[11] See also Guzman's general conclusion that the extraterritorial application of regulations tends to lead to an inefficient overregulation of global economic activities in A. T. Guzman, *Choice of Law: New Foundations* (2002) 90 Georgetown Law Journal 883, 906; for a general economic analysis of private international law rules, see, e.g., J. Basedow and T. Kono (eds.), *An Economic Analysis of Private International Law* (Mohr Siebeck, Tübingen 2006).

D. Searching the Optimal Combination of Harmonisation and Decentralisation in a Multi-level-System of Competition Laws

Whether and what type of regulatory competition can be recommended requires also a thorough analysis of the advantages and disadvantages of centralisation (harmonisation) and decentralisation, i.e. the whole multi-level legal system including its vertical allocation of regulatory powers must be analysed. This is the main insight of the economic theory of legal federalism (as presented in section B). This shifts the discussion on international competition policy into a different direction, because the focus is now less on a direct approach to convergence and coordination of competition policies but more on the appropriate design of an integrated multi-level system of competition law regimes. In such a system there can be substantial and procedural competition law rules as well as competition authorities and courts on the global level, the level of regionally integrated markets (as the EU), on the national levels, and even on subnational levels (as eg the state level in the U.S.). The whole set of economic criteria for the vertical allocation of competences can be applied for analysing, under what conditions what types of anticompetitive behaviour should be dealt with from the competition law regimes on the different jurisdictional levels. Such a system can also have different degrees of decentralisation in regard to substantial competition law rules on one hand and enforcement agencies and courts on the other hand.[12] From our analysis of competition of competition laws, we can conclude that regulatory competition through free choice of law should not be a part of such a multi-level system, and that also regulatory competition through interjurisdictional competition and international trade of goods might not be able to contribute many positive effects (rather the pernicious effects of strategic competition policies should be avoided). However, the advantages of decentralised experimentation with different competition policies and the ensuing potential of mutual learning can benefit considerably to the long-term effectiveness of the competition law regimes. Therefore this type of regulatory competition should be an inherent part of the global multi-level system of competition law regimes. Of course, such an argument in favour of a more decentralised system must be balanced with the results from other criteria which might lead to the recommendation of a more centralised (or harmonised) competition law regime. An essential part of such a multi-level system of competition law regimes are the rules for the horizontal and vertical delimitation of competences, and the rules that govern the cooperation and mutual support of the competition authorities (as enforcement agencies) within the system. It is particularly this framework of rules for the governance of a multi-level competition policy regime that is crucial for the effective protection of competition in a world with multiple competition law regimes.

From this theoretical perspective of legal federalism *Oliver Budzinski* has analysed how a multi-level system of competition policies should look like in his recently pub-

[12] For example, within the EU we have a combination of a rather centralised (and harmonised) competition law on the European level, whereas the enforcement of European competition law has undergone a process of decentralisation, which is additionally promoted through the efforts to strengthen private enforcement. For a recent thorough analysis of the vertical allocation of competences in the field of competition law within the EU, see R. J. Van den Bergh and P. D. Camesasca, *European Competition Law and Economics: A Comparative Perspective* (Thomson, London 2006), 402-446; for a defence of US antitrust federalism see H. First, *The Role of the States in Antitrust Enforcement* (2001) 69 George Washington Law Review 1701.

lished book "The Governance of Global Competition".[13] From the general set of economic criteria for the vertical allocation of regulatory powers he selects five groups of criteria that he deems as particularly important for competition policy: (1) Externalities and spillovers (international externalities through under-enforcement of competition laws and strategic competition policies; geographical scope of competition problems); (2) cost efficiencies (in terms of production, transaction, and administrative costs); (3) preference orientation (degree of heterogeneity of objectives for competition laws); (4) agency problems and lobbyism (rent seeking problems); (5) Institutional evolution and adaptability (innovation and adaptability of competition laws to change; importance of limited knowledge and theory pluralism). He shows that neither the traditional decentralised system of national competition laws (despite their extraterritorial application through the effects doctrine) nor a centralised uniform global competition policy regime is an appropriate solution according to these economic criteria; rather a sophisticated combination of centralisation and decentralisation should be preferred. After providing an analytical overview about the US antitrust system and the EU competition policy system as existing multi-level competition policy regimes, he focusses his analysis on the so far widely neglected rules for the allocation and (horizontal and vertical) delimitation of competences in a multi-level system of competition laws. He examines nine different rules for dealing with cross-border conflicts which decide upon the competition law regime that should have jurisdiction over a case within a global multi-level competition law regime. The most important ones are the effects doctrine, turnover thresholds, nondiscrimination rule (national treatment), principle of origin, the relevant markets rule, X-plus rule, advanced comity principle (voluntary lead jurisdiction), and the mandatory lead jurisdiction model. The above five groups of economic criteria are used for assessing the effects of these different rules. His overall results are that the mandatory lead jurisdiction model, the nondiscrimination rule, and the advanced comity principle score best, whereas the effects doctrine ranks last.[14] This conforms to our negative assessment of the effects doctrine at the end of the last section C.

E International Competition Network as an Institutional Device for Decentralised Experimentation and Mutual Learning or for Harmonisation? Some Conclusions

The International Competition Network (ICN) is an astonishing institutional innovation, both theoretically and practically.[15] The ICN is a network of national competition authorities from all over the world, which has the objectives of promoting the spreading and convergence of competition law, eg by identifying and recommending best practices

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[13] See Budzinski (n. 1); see also W. Kerber, *An International Multi-Level System of Competition Laws: Federalism in Antitrust*, in J. Drexl (ed.), *The Future of Transnational Antitrust – From Comparative to Common Competition Law* (Bern 2003); O. Budzinski and W. Kerber, *Internationale Wettbewerbspolitik aus ökonomischer Perspektive*, in P. Oberender (ed.), *Internationale Wettbewerbspolitik* (Duncker & Humblot, Berlin 2006).

[14] See Budzinski (n. 1), 151-217.

[15] See for analyses of the ICN E. M. Graham, "*Internationalizing*" *Competition Policy: An Assessment of the Two Main Alternatives* (2003) 48 Antitrust Bulletin 947; O. Budzinski, *The International*

in competition law regimes. A decisive feature of the ICN is its voluntary non-mandatory character, i.e. it does not intend to establish mandatory rules on the global level, neither in regard to minimum standards for substantial competition law nor in regard to jurisdictional issues. Theoretically, it is an example of "soft law" as a new form of governance, which became popular since the 1990s. The basic idea of this form of governance is that the exchange of information and experience, the discussion about best practices and, last but not least, peer pressure would lead to processes, in which the agencies learn mutually from each other and develop common principles with the aim of improving policies and leading to more convergence. Another interesting institutional innovation is that the competition authorities and not the governments are the participants in this international institution. An important objective of the ICN is the promotion of the spreading of competition laws all over the world, particularly helping developing and newly-industrialised countries in establishing effective competition law regimes.

What have been the main activities and achievements of the ICN so far? Founded in 2001 by 15 competition authorities, the ICN now consists of more than 100 agencies from ca. 85 countries. There are annual conferences prepared by a Steering Group of fifteen members (with an annually rotating Chair), but there is no formal organization with a budget and permanent staff. The ICN has established a considerable number of working groups about a wide range of issues relevant for the application of competition law. These working groups produced a number of reports and were also able to agree on some guidelines and policy recommendations (formally accepted at the annual conferences).[16] Most prominent were the activities in the realm of merger policy. "The mission of the ICN Merger Working Group is to promote the adoption of best practices in the design and operation of merger review regimes in order to: (i) enhance the effectiveness of each jurisdiction's merger review mechanisms; (ii) facilitate procedural and substantive convergence; and (iii) reduce the public and private time and cost of multijurisdictional merger reviews".[17] The Merger Working Group developed eight Guiding Principles and thirteen Recommended Practices for the notification of mergers and the procedures of merger review, which was accompanied by an Implementation Handbook and a report about the experience with their implementation. In regard to merger investigation and analysis a checklist of relevant topics was prepared for the development of merger guidelines (Merger Guidelines Workbook). The work of the ICN Cartels Working Group focussed mainly on the issues effective detection, investigation, and punishment of hard-core cartels, and on specific investigation techniques.for anti-cartel enforcement. In regard to competition rules against the abuse of dominant firms, the Unilateral Conduct Working Group prepared a "Report on the Objectives of Unilateral Conduct Laws, Assessment of Dominance/Substantial Market Power, and State-Created Monopolies" in 2007, in which also the general objectives of competition laws have been treated.

It is not possible here to analyse the results these working groups have achieved so far. Some of these working groups have already presented clear results, others are still working, and also new workings groups about additional issues have been established. In that respect, this is an ongoing process. A first glance on the issues and results, however,

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Competition Network: Prospects and Limits on the Road Towards International Competition Governance (2004) 8 Competition and Change 223.

16 For these reports see www.internationalcompetitionnetwork.org.

17 ICN, Merger Working Group, *2007-2008 Work Plan*, p. 1; available at: www.international competitionnetwork.org.

shows that the activities of the ICN have focussed primarily on procedural issues (as, e.g., procedural rules in merger reviews or how to improve the effectiveness of competition law enforcement) and hardcore restrictions as price cartels, which are less controversial. It is not surprising that more controversial issues as substantial merger review criteria, cartel exemptions, and industrial policy questions have been adressed much more cautiously or so far not at all. However, a preliminary assessment cannot deny that the ICN has stimulated a lot of valuable activities and change, and therefore has contributed to the spreading of practices and methods for making competition law regimes more effective.[18]

How can the ICN fit into the notion of such a global multi-level system of competition law regimes that we have sketched in section D? How does the ICN relate to regulatory competition in competition law? In a recent contribution, *Meessen* claims that the ICN is a much more appropriate solution for international competition problems than the alternative option of the establishment of internationally binding competition rules within the WTO framework. He views some of the pros for a WTO solution (as helping developing countries or solving jurisdictional conflicts) as less important (because also the ICN contributes to their solution) and some of the cons re-enforced (as an overburdening of the WTO). However, in his view the most important argument is that the ICN allows for an open-ended dynamic process of competition of competition laws compared to the danger of an harmonisation within the WTO framework.[19] On one hand, I agree with this assessment. *Meessen's* notion of competition of competition laws refers to our fourth type of regulatory competition (in section C), i.e. indirect regulatory competition via yardstick competition. In the above analysis, we have seen that this is the type of regulatory competition which can contribute a lot to the long-term improvement of the effectiveness of competition law regimes (through decentralised experimentation and mutual learning), whereas other types of competition of competition laws might raise (more or less serious) problems. This is also one of the main reasons why a fairly decentralised multi-level system of competition law regimes can be recommended from an economic perspective. In particular, through its efforts to promote mutual learning through identifying and recommending best practices, the ICN also seems to support this type of competition of competition laws. On the other hand, the long-term effects of the ICN on decentralised experimentation and learning might be much more ambivalent, because the explicit endeavours in regard to convergence might be a pathway to harmonisation.

In that respect, some lessons might be learnt from another example of this form of governance, i.e. the "Open Method of Co-ordination" (OMC) within the EU. The basic idea of the OMC is similar to the ICN. Economic and social policies of the Member States of the EU are analysed on the EU level in regard to their effectiveness, best practices are attempted to be identified, and policy recommendations are made to the Member States. Also here the Member States retain their competences in deciding themselves about the

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[18] For a first empirical analysis of the impact of policy recommendations of the ICN see S. J. Evenett and A. Hijzen, *Conformity with International Recommendations on Merger Reviews: An Economic Perspective on "Soft Law"* (2006) (mimeo).

[19] See K. M. Meessen, *ICN Accompanied Convergence, instead of WTO Imposed Harmonization, of Competition Laws*, in: H. Hohmann (ed.), *Agreeing and Implementing the Doha Round of the WTO* (Cambridge University Press 2008), 223.

compliance with these policy recommendations (due to the voluntariness of the OMC).[20] From a theoretical perspective, the basic mechanism is somewhat similar to our last type of regulatory competition, because also here knowledge about appropriate policies is generated through decentralised experimentation with different policies and a process of mutual learning. The main difference is that in regulatory competition this … process takes place only on a decentralised level, whereas within the OMC it is organised on a central level, i.e. it is partly top down. One of the problems that emerged in the discussion on and the experiences with the Open Method of Co-ordination is that often no clear "best policy" exists, because what is optimal depends on the specific conditions and normative preferences in the countries which often differ. A still more important problem is that the EU emphasizes (similar to the ICN) the spreading of best practices, which leads to convergence. This is short-sighted, because the learning mechanism also needs new innovations, ie also new policy experiments are necessary, from which in the future new best practices can be learnt and spread to other jurisdictions. Therefore it is not clear whether the OMC is primarily an institutional device for organizing a permanent process of improving policies through decentralised experimentation and mutual learning or whether it is foremost an instrument for achieving convergence (and harmonisation) of policies, for which the competences are still on the Member State level. Many scholars think that the OMC is intended by the EU Commission to be primarily an instrument for convergence and harmonisation. However, the OMC could also be conceptualised as a long-term institution that supports to reap the advantages of decentralised experimentation and mutual learning. This would be compatible with laboratory federalism and regulatory competition (via yardstick competition).[21]

The similarities to the ICN are obvious. If the ICN views itself only as an institution, which aims at identifying once and for all what the best practices in protecting competition are, and attempts to spread this knowledge to all countries, then a lot of mutual learning takes place. However, the final result would be much convergence and, ultimately, harmonisation of competition law regimes. Of course, this also has positive effects, because it reduces problems as conflicts through contradictory decisions. However, from the perspective of legal federalism an overall convergence and harmonisation might have very serious negative effects in the long run, because it endangers or even eliminates future processes of decentralised experimentation and mutual learning, and therefore that beneficial type of competition of competition laws. Therefore it is important that the ICN should focus not primarily on the objective of convergence but more on the objective of being an institution that supports the long-term evolution of effective competition law regimes by providing a forum for the exchange and discussion of experiences with old and new practices and methods. The danger is that, in the long run, experimentation with new practices and methods might be discouraged through emphasizing too much the need of conformity with "best practices". The OMC within the EU clearly has such an impact. Of course, this danger is considerably smaller in the ICN. However, the ICN

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20 However, the EU has (contrary to the ICN) a number of instruments which limit this voluntariness.

21 See for this argumentation in more detail W. Kerber and M. Eckardt, *Policy Learning in Europe: The Open Method of Co-ordination and Laboratory Federalism* (2007) 14 Journal of European Public Policy 227; see generally for the OMC also S. Borrás and B. Greve (eds.), *The Open Method of Co-ordination in the European Union* (2004) 11 Journal of European Public Policy: Special Issue.

should be aware of this danger, and also take into account the need for experimentation with new practices and methods as well as the insight that appropriate competition law regimes might differ according to different conditions and normative preferences. If the ICN pays attention to these problems, then it can contribute a lot to the evolution of effective competition law regimes also in the future.

However, we also should be aware that the ICN through its voluntary character cannot contribute much to the solving of jurisdictional conflicts which arise through the decentralised decision-making in competition cases and the application of the "effects doctrine". Therefore an overall set of rules for allocating and delineating properly the competences in a multi-level system of competition law regimes is still missing. The approach to develop a consistent multi-level system of competition law regimes (section D), which solves these problems without eliminating decentralised experimentation and mutual learning (as the beneficial type of competition of competition laws) is, in my view, still the most promising perspective for finding a long-term solution for the global governance of international competition problems.

Economic Law Between Harmonization and Competition: The Law & Economics Approach

Peter Behrens[*]

This contribution will analyse the tension between competition and harmonisation[1] of national systems of economic law from a law & economics perspective. We will, firstly, set out a short account of the law & economics approach and of the role it ascribes to economic regulation (A.). Secondly, we shall explain why regulation may be regarded as an economic good for which there is a market (B.). Thirdly and fourthly, the concept of regulatory competition (C.) as well as the role of harmonisation (D.) will be analysed. Finally, we shall offer some general conclusions (E.).

A. Law & economics: The market paradigm applied to law

The law & economics approach (economic analysis of law, new institutional economics) may by characterised in the following terms:

> "The economic analysis of law involves three distinct but related enterprises. The first is the use of economics to predict the effects of legal rules. The second is the use of economics to determine what legal rules are economically efficient, in order to recommend what the legal rules ought to be. The third is the use of economics to predict what the legal rules will be. Of these, the first is primarily an application of price theory, the second of welfare economics, and the third of public choice."[2]

A common denominator of these three ways of using economics for the analysis of law is the application of the market paradigm (i.e. the neoclassical micro-economic approach) to legal institutions.[3] The effects of legal institutions in terms of their efficiency implica-

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[1] Most economists distinguish „ex ante" harmonization by way of legislation and "ex post" harmonization which may be the result of regulatory competition. Taken in the latter sense, there is no contradiction or tension between competition and harmonization. For the purposes of this paper, the term harmonization is referring to "ex ante" harmonization unless indicated otherwise.

[2] D. Friedman, *law and economics*, in: *The New Palgrave – A Dictionary of Economics* (London, 1987) Vol 3, at 144.

[3] See for a most encompassing account of this approach E. Furubotn & R. Richter, *Institutions and Economic Theory: The Contribution of the New Institutional Economics* (Ann Arbor, 1997).

tions as well as the ways such institutions emerge are analysed within the general framework of markets. Markets are large networks of interaction between market operators who all want to promote their individual welfare. Markets allow for the coordination of an indefinitely large number of individual "welfare functions" by means of voluntary transactions between the market operators. They tend towards an allocation of scarce resources which mirrors the individual welfare objectives (preferences) of market participants, i.e. towards "allocative efficiency". Markets are unable to accomplish their welfare (efficiency) enhancing role, however, unless proper institutions are put into place by state legislators which provide the legal means for the implementation of market transactions. On the other hand, the ability of markets to solve allocative problems by voluntary transactions between market actors is not without limitations. Under certain circumstances, markets tend to "fail". Such "market failures" may call for corrections by way of another type of state regulation which interferes with voluntary market transactions so as to avoid their inefficient effects. The economic functions of legal institutions are therefore twofold: In order for markets to function efficiently, "enabling laws" need to be put into place; in order for market failures to be corrected, "corrective regulations" must be implemented.

"Enabling laws" encompass all legal institutions which are necessary in order to make the efficient operation of markets possible. Such laws include, most importantly, the laws of property, contracts, torts, partnerships, companies etc. The laws of property allow for the allocation of resources (goods) to individual persons who may then exclude others from making use of such resources, unless the latter are willing to buy the goods, i.e. compensate the initial owners for giving up their exclusive property rights. Since such exchanges of goods for money are based on mutual agreements between the parties, they reflect the parties' individual preferences and put both sides of the transaction in a better position than before the exchange. In other words: Voluntary market transactions are, in principle, welfare enhancing (efficient). The law of contracts provides legal certainty regarding the implementation of such transactions and the law of torts makes sure that even an involuntary "use" of another person's property must be paid for in terms of damages. Partnership and company laws enable market operators to join productive efforts and engage in and finance welfare enhancing activities which would not be possible otherwise. So, in sum, all these fundamental legal institutions allow markets to operate efficiently, provided they are designed in a way that saves transaction costs. Market transactions involve various transaction costs (i.e. costs for searching, negotiating and enforcement) which may be heavily affected by the way the relevant legal institutions are designed by legislators.

"Corrective regulations" encompass all legal institutions which are necessary to eliminate inefficiencies resulting from market failures. Within the present context, three types of market failures are of primary importance: "informational asymmetries", "externalities" and "public goods".[4]

"Informational asymmetries" tend to distort the allocative effects of market transactions. An efficient allocation by market transactions presupposes that the parties are fully informed about the properties and qualities of the objects (i.e. goods or services) to be exchanged. If only one of the parties lacks full information (where, in other words, relevant

[4] See for a definition and application of these three concepts in the context of the regulation of professional services: European Commission, *Report on Competition in Professional Services*, COM (2004) 83, Brussels 9 February 2004, 25-27.

information is asymmetrically distributed between the parties), the voluntary transaction does no longer lead to an efficient allocation of resources in terms an enhancement of individual welfare according to the parties' preferences. There are many goods (like used cars) and services (like professional services) the quality of which cannot easily be assessed by consumers, neither by observation, nor by consumption or use. Consequently, there is no way how consumers can find out whether what they acquire is worth the price. If the providers of such goods or services are substantially better informed than the consumers, they may charge prices above the value that consumers would otherwise attach to the goods or services. In other words, producers will have an incentive to offer lower quality goods or services and price competition may lead to a vicious circle of lower prices and lower quality until the market breaks down.[5]

"Externalities" exist whenever a transaction involves negative or positive third party effects without compensation of or by the third party. This may occur where a bilateral agreement leads to the use of a resource which is beneficial to the parties to the agreement but detrimental or beneficial to another person not party to the agreement. The latter party's preferences then remain "outside" the market. They are "external" to the price mechanism. Negative or positive "externalities" are goods which are exchanged on an involuntary basis. Such "externalities" are therefore inefficient. In case of a negative "externality", the third party bears part of the costs of production of the good or service without benefiting from their use; in case of a positive "externality", the third party reaps parts of the benefits of the production of the good or service without contributing to the costs of production. This leads to an inefficient over- or underproduction. A good example are negative or positive environmental effects caused by the production or use of certain goods or services.

"Public goods" are the opposite of "private goods" in terms of excludability of third parties from using the good and in terms of rivalry of use. "Public goods" are not subject to a regime of property rights that provide the owner a right to exclude third parties from using the good; and also, these are goods which may be used by many persons at the same time without mutual interference. Markets do typically not provide such goods (such as the correct administration of justice or national security), because the producer would have no chance to recover the production costs by selling them. If nobody can be excluded from using the good, nobody can be expected to pay for getting access to the good. The result is an inefficient underproduction of these goods by the market. This is inefficient to the extent that it does not reflect the prevailing preferences of most if not all people who would want to benefit from such goods.

In order to restore the market's efficiency, governments may interfere with the "failing market" by way of proper "corrective" regulation. Such regulations may protect consumers against poor quality goods or services by imposing quality standards and disclosure obligations; they may internalise externalities by property or liability rules which prevent the causation of external effects or call for compensatory payments to the parties affected; and they may promote the supply of public goods by imposing upon the citizens an obligation to contribute (e.g. by way of taxes) to the costs of their production. In sum then, governments regulate those activities which private markets are unable to carry

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[5] This phenomenon was first analyzed in a seminal paper by G. A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, Quarterly Journal of Economics 84 (1970) 488-500.

out efficiently. According to *Sinn*, "corrective" regulation is therefore based on a "selection principle".[6]

However, even from a law & economics perspective, regulators are not necessarily limited to eliminating "market failures". It is legitimate for governments to also pursue distributive objectives (social justice), provided only that this is in compliance with consumer-voters' revealed preferences. The promotion of social justice may also be indirectly related to efficiency considerations, because it may contribute to the avoidance of social unrest and to the acceptance and stability of the market system.

A very important insight from a law & economics perspective, especially from its public choice branch, relates to the fact that governmental regulation may suffer from specific failures ("regulatory failures") as well.[7] Incomplete information of the government about peoples' preferences may prevent the achievement, by means of regulation, of a more efficient allocation of resources than would otherwise prevail within a failing market. This may lead to an overproduction of public goods and a waste of resources. Another factor that may contribute to "regulatory failure" is the pervasive risk of "regulatory capture" of governments by the special interests of those to be regulated. Most economic sectors are well organised in the form of interest groups which may exercise pressure on government agencies so as to shift the costs of regulation to third parties which are less well organised.[8] Finally, government agencies suffer from principal-agent problems. Regulators are "agents" of the "public interest", i.e. of the people at large which is their "principal". Since economic theory is based on the assumption, however, that individuals always do what is also in their own best interest, regulators must be regarded as also acting in their individual interest which cannot be expected to coincide with the public interest. All available control mechanisms which are designed to make sure that governments promote the "public interest" rather than the individual interest of their members, cannot avoid a certain divergence of interests which systematically leads to regulatory inefficiencies. In addition, social choice theory asserts that regulation cannot embody a "public interest" in the sense of an aggregation of the preferences of the electorate in the first place. It posits that it is impossible for a "public interest" to emerge in political practice because voting paradoxes prevent the emergence of a preference ordering for public goods.[9]

Consequently, the benefits derived from regulations to eliminate market failures must always be balanced against the potential inefficiencies resulting from regulation itself. The important lesson therefore reads as follows: *Market failures warrant regulation only, if regulation leads, on balance, to an overall reduction of inefficiencies.*

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6 H-W. Sinn, *The Selection Principle and Market Failure in Systems Competition*, Journal of Public Economics 66 (1997), 247-74; id, *The New Systems Competition* (Oxford, 2003), 6: "The Selection Principle says that governments have taken over all those activities which the private market has proved to be unable to carry out."

7 See A. I. Ogus, *Regulation – Legal Form and Economic Theory* (Oxford, 1994), 30.

8 See the seminal papers by G. Stigler, *The Theory of Economic Regulation*, Bell Journal of Economics and Management Science 2 (1971), 3-21, and R. A. Posner, *Theories of Economic Regulation*, Bell Journal of Economics and Management Science 5 (1974), 335-358.

9 See the seminal work of K. J. Arrow, *Social Choice and Individual Values* (New Haven, 1951).

B. Regulation as an economic good

So far, we have discussed economic law and, more specifically, governmental regulation as a set of rules and institutions which are "applied" to markets for goods, services and factors of production so as to either enable efficient market transactions to take place or to correct inefficiencies that may exist due to market failures. According to the law & economics perspective, the market paradigm may, however, also be applied to regulation itself. This means that we may look at regulations as products "offered" and "sold" by governments to consumer-voters on "markets for regulation".[10] Irrespective of whether regulation is designed to eliminate informational asymmetries, to internalise external effects or to produce certain public goods, its efficiency enhancing function represents itself a public good (i.e. a good from which everybody, who is a "member" of the group to whom the good is supplied, may benefit).

Consequently, regulations may be regarded as "public goods" offered by governments to their constituencies (consumer-voters) which "pay" by casting their votes in democratic elections in favour of governments that offer such public goods. "Democracy" is therefore just another word for the "political market" where political entrepreneurs (political parties) compete for the votes of the electorate by offering the most attractive selection of "public goods" in terms of welfare enhancing regulations. By opting for a specific selection of public goods consumer-voters at the same time also opt for a specific selection of obligations to contribute to the financing of the respective costs of production of public goods (in particular taxes). Governments therefore behave like firms which compete for customers by offering them those combinations of prices (taxes) and (public) goods which they prefer.

Environmental regulations are a good example: A natural and healthy environment is a public good that benefits the whole population living in that environment. Its "production" clearly requires adequate governmental regulation, because, due to deficient property rights in environmental resources, the market would not take care of a natural and healthy environment. To the extent that the population has a collective preference for a natural and healthy environment, people will vote for a government that is willing and able to enact the necessary regulations. Public goods – as any good – cannot be produced without costs however. The costs are borne by those whose activities are directly or indirectly negatively affected by governmental regulations. Such regulations typically impose prohibitions (i.e. obligations to refrain from certain conduct) or prescriptions (i.e. obligations to positively behave in certain ways). They thereby redistribute property rights among market actors. In other words: regulations interfere with market transactions so as to make them compatible with the regulatory objectives. Market operators are thus forced by the government to adjust their market conduct to the requirements of the provision of the public goods.

The provision of public goods by governmental regulation is efficient to the extent that it truly reflects the collective preferences of the population at large ("the public"). If, however, the beneficiaries of governmental regulation and those who "pay" for it by suffering limitations of their property rights are not identical, as is often the case, governmental regulation has asymmetric effects on different parts of the population. Then there are winners and losers of regulation. In other words, most of the time regulations

[10] The idea that regulation is just a kind of good subject to demand and supply was first introduced by G. J. Stigler, supra footnote 8.

have redistributive effects. Losers may then have an incentive to look for a change of their situation.

In the present context, another important aspect of the public goods character of regulation needs to be emphasised: Governments offer various kinds of regulations not separately, but always as whole bundles of different regulations. Those who are subject to "corrective" state regulation, cannot selectively accept a specific set of regulations (say: environmental regulations) and reject other regulations (say: tax laws) which form part of the same regulatory system. The regulatory system of a specific jurisdiction normally covers a very large number of fields such as tax laws, environmental laws, consumer protection laws, social security legislation, banking regulations etc. Only to the extent that different political parties competing for government offer different bundles of regulations (public goods), may consumer-voters have a certain degree of choice. In assessing these bundles of regulations, they have to balance the benefits derived from the elimination of market failures against the redistributive consequences that may affect them.

C. Regulatory Competition

I. The Concept

Governmental regulations are, in principle, public goods provided within the framework of nation states. The jurisdiction to regulate is normally based on either the territoriality principle or the nationality principle. Roughly speaking, the territoriality principle authorises states to regulate the conduct of all people within the territory; the nationality principle authorises states to regulate conduct of their nationals even outside the territory, although the enforcement of such regulations is, again for jurisdictional reasons, limited to the territory of the regulating state. Regulatory systems therefore normally exist within the framework of nation states. Subject to unavoidable regulatory failures mentioned above, they reflect the preferences of each state's electorate regarding the elimination of market failures by the government. Since these preferences are different from country to country, the regulatory consequences of the application of the "selection principle" by national governments is very different also. In other words: the mix of "enabling laws" and "corrective regulations" differs widely from state to state.

Those who are subject to a specific regulatory system, but do not share the preferences actually reflected in that system, may potentially use two strategies for bringing about change. *Hirschman,* in his seminal study on the theory of institutions, has coined these two strategies "voice" and "exit".[11] "Voice" implies that those who are opposed to the prevailing system of regulation would stay within the jurisdiction and use their political voting power to bring about a change of government. This strategy is clearly predicated on the existence of political competition between parties who offer different sets of regulations (public goods). The second strategy implies that the opponents to the prevailing system of regulation leave the jurisdiction and enter another jurisdiction which offers a different set of regulations. This strategy is based on the condition that people have a certain freedom of choice between different sets of regulations so that they may opt out

[11] A. O. Hirschman, *Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations, and States* (Cambridge, Mass, 1970), 22.

of the system which they dislike and opt into a system which they find preferable. Both strategies lead to interjurisdictional competition, though in very different ways.

As far as the "voice" strategy is concerned, interjurisdictional competition is based on an international exchange of ideas which may shape the preferences of consumer-voters with regard to the supply of regulations (public goods) by their national governments. These preferences, which determine the political competition within each jurisdiction, are more or less heavily influenced by an interjurisdictional "ideological" competition. Competing ideas about the preferable mix of "enabling laws" and "corrective regulations" are also a matter of various international research agendas. The comparative analysis of economic and legal systems has been an important scientific discipline since many decades. The prominent German school of ordo-liberalism has from its very beginning in the 1930ies focussed on comparative systems analysis even before the law & economics movement developed. Its main focus was the structural difference between two types of systems: those that combine the political and the economic subsystems within one system which is based on central planning by the government, on the one hand, and those that separate the political and the economic subsystems leaving the latter to decentralised planning by market operators who coordinate their individual planning by market transactions. Historically, socialist systems have opted for the first model, capitalist systems for the second. Even within the capitalist world, we find remarkable differences of regulatory systems however. The American rule based way of regulating capitalism, the German way of balancing the institutions of a social market economy and applying a more principle based approach to economic regulation, and the French way of combining state planning and a strong preference for public services with a system of market transactions – all of these institutional arrangements are in a sense competing among each other.[12] The law & economics movement has just begun to study, on a comparative basis, the operation of laws, regulations and other institutions in market economies which ascribe quite different roles to the market and the state, in other words to economic and to political competition.[13] This truly international debate will certainly have an impact upon people's preferences and their "voice" strategies.

The "exit" strategy clearly leads in a more direct way to interjurisdictional competition between national regulatory systems. The neoclassical concept of regulatory competition was first introduced by *Tiebout* within the framework of his theory of fiscal federalism[14] which attempted to prove that, in a federal system, decentralized regulation (taxation) and regulatory (fiscal) competition may be preferable to centralised regulation (taxation) without such competition. This approach was later expanded to the provision of "public goods" by means of regulation generally and used to analyse the allocation of the jurisdiction to regulate in federal systems such as the United States and the European

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[12] See for a very insightful comparative sociological analysis of the North American and the French models of regulating the economy Y. Dezalay, *Between the State, Law, and the Market: The Social and Professional Stakes in the Construction and Definition of a Regulatory Arena*, in: W. Bratton, J. McCahery, S. Picciotto & C. Scott (eds.), *International Regulatory Competition and Coordination – Perspectives on Economic Regulation in Europe and the United States* (Oxford, 1996), 59-87.

[13] See U. Mattei, *Comparative Law and Economics* (Ann Arbor, 1998).

[14] C. M. Tiebout, *A Pure Theory of Local Expenditures*, Journal of Political Economy 64 (1956), 416-424.

Community.[15] According to the *Tiebout* model, consumer-voters of different jurisdictions may reveal their preferences for a particular set of public goods by moving from one jurisdiction to another, thus signalling their preferences for these goods. The model simulates an interjurisdictional market where public goods are financed by taxes which are paid by the consumer-voters who move from one jurisdiction to another according to their preferences. The model counterfactually assumes that consumer-voters are fully mobile, that they are fully informed about the different sets of public goods offered by the different jurisdictions, that there is a sufficiently large number of different jurisdictions reflecting the different preferences of consumer-voters, that there are no employment problems which may restrict the mobility of consumer-voters, and that jurisdictions have an optimal size in terms of the number of residents to whom the various sets of public goods can be supplied at lowest average cost. Even though these assumptions are extremely restrictive, the model highlights the theoretical possibility of regulatory competition. And even though the model counterfactually assumes regulatory competition to be perfect, it allows us to identify the prerequisites for a less than perfect, but nevertheless beneficial, regulatory competition.

The modern law & economics approach to regulatory competition is, however, not limited to an application of the narrowly defined *Tiebout* model which neglects, in particular, the existence of transaction costs and the innovative role of competition[16] which is emphasised by the evolutionary approach. This approach, which is based on *Hayek's* conception of competition as a "discovery procedure",[17] understands competition as a dynamic process which brings about innovations and the creation of new knowledge. Applied to interjurisdictional competition, this means that different jurisdictions will continuously endeavour to produce innovative public goods (in particular: regulations) which will offer increased possibilities of return to the customer-voters "using" such regulations.[18] Other jurisdictions will try to imitate these innovations if they consider them to be superior solutions. "The result is a continuous difference in quality or quantity of the public goods offered in the various jurisdictions, which contrasts to the world of neoclassical economics with the notion of homogeneous goods, of equilibria and of perfect knowledge".[19] Consequently, possible deficiencies of the real process of regulatory competition that may be identified on the basis of the *Tiebout* model are not necessarily a good reason to discard regulatory competition altogether. From an evolutionary point of view it may still lead to regulatory improvements, although in an incremental way.

The following considerations focus on the most important aspects of regulatory competition, in particular, on interjurisdictional mobility, the object of consumer-voters'

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15 See, eg, G. A. Bermann, *Taking Subsidiarity Seriously: Federalism in the European Community and the United States*, Columbia Law Review 94 (1994), 331-456.

16 See Tjiong, *Breaking the Spell of Regulatory Competition: Reframing the Problem of Regulatory Exit*, Rabels Zeitschrift 66 (2002), 66-96, at 72.

17 See F. A. Hayek, *Competition as a Discovery Procedure*, in: F. A. Hayek, *New Studies in Philosophy, Politics, Economics and the History of Ideas* (London and Henley, 1978), 179-190.

18 See V. Vanberg & W. Kerber, *Institutional Competition Among Jurisdictions: An Evolutionary Approach*, Constitutional Political Economy 5 (1994), 193-219; W. Kerber & V. Vanberg, *Competition among Institutions: Evolution within Constraints*, in: L. Gerken (ed.), *Competition among Institutions* (Basingstoke, Hampshire, 1995), 35-64.

19 J. Sideras, *Systems Competition and Public Goods Provision*, Jahrbuch für Neue Politische Ökonomie 19 (2000), 157-178, at 169.

choice in case of an "exit", parametric interdependence of governments competing for consumer-voters and, finally, potential failures of the market for regulations. In light of all this, the likelihood that regulatory competition may be workable will then be assessed.

II. Interjurisdictional Mobility

The first most important condition for regulatory competition is the mobility of consumer-voters. Such mobility may be based, first of all, on physical cross-border movements of persons or enterprises involving a change of nationality, a relocation of the residence of persons or a transfer of the central place of business from one jurisdiction to another. However, physically leaving the territory of a specific jurisdiction does not necessarily imply an "exit" from the jurisdictional scope of application of a national regulatory system. As has been mentioned already, the applicability of national regulations to specific transactions is not necessarily based on the residence or presence of persons within the territory of the regulating state (territoriality principle); the scope of application may as well be based on the nationality of the addressees of laws and regulations (nationality principle), and in some important fields of regulations even on the domestic effects of transactions outside the jurisdiction (effects principle). Some regulations are therefore subject to "extraterritorial" application. Rules against restraints of competition (antitrust laws) are a prominent example for this latter possibility. To the extent that national regulations are applied not only domestically, but also on an extraterritorial basis, the "exit" strategy is only available, if practically all transactional links to the relevant jurisdiction are cut off so as to avoid any "effects" that may trigger the application of that jurisdiction's regulation. In a modern globalised world, this is no practical option. The jurisdictional "effects" principle clearly limits the scope of regulatory competiton.

Another aspect of mobility relates to interstate trade in goods or services which are produced in compliance with the regulations (product standards) of a specific jurisdiction. To the extent that goods or services may be exported from this jurisdiction, consumers in other jurisdictions have a choice between domestic and imported goods or services, provided the importing state does not subject the imported goods or services to its domestic regulations (i.e. product standards are applied according to the country of origin principle). In making this choice, consumers implicitly reveal their preferences for the regulations according to which the goods or services have been produced. Freedom of trade in goods or services may therefore also lead to an "exit" of consumers from their national system of regulations and to interjurisdictional regulatory competition.

However, the "exit" strategy needs not always be based on the physical mobility of persons, enterprises, goods or services. In other words, a choice between different regulations may not always require a physical movement from one jurisdiction to another. Interjurisdictional mobility may also rely on persons' freedom to directly choose among alternative sets of regulations, e.g. by means of "choice of law" clauses or by "forum shopping". Such freedom of choice of law may be granted to persons irrespective of their intra- or extra-jurisdictional nationality or residence, because persons' nationality or residence may not be the relevant connecting factor for the application of certain laws or regulations in the first place. This is, in principle, true for rules of "private law" (in particular the law of contracts), so that persons may freely directly choose the national laws applicable to their transactions. To the extent that this is the case, persons don't

have to leave their domestic jurisdiction in order to avoid the application of domestic laws. They are rather in the comfortable position to be able to select the preferred set of legal rules from a large number of competing sets of regulations offered by different jurisdictions.

In sum, "exit" strategies are based on interjurisdictional mobility which comes in various forms. But even where such mobility is limited, regulatory competition will exist and exercise a certain degree of competitive pressure on national regulatory systems, especially if "voice" strategies that are based on interjurisdictional "ideological" competition (i.e. on the mobility of ideas) are also taken into consideration

III. The Object of Choice

What has just been said about the different possible "exit" strategies, has some important implications for the precise determination of the object of consumer-voters' choice. Contractual "choice of law" clauses have only limited effect in terms of the scope of the derogation from a specific regulatory system, because only the rules of contract law of one jurisdiction are substituted by the rules of contract law of another jurisdiction. A similar limitation is characteristic for "forum shopping" strategies. On the other hand, a change of nationality, a relocation of the residence of persons or the transfer of the principal place of business of an enterprise to another jurisdiction has a much broader impact, because it may indeed lead to the substitution of a whole regulatory system by another system. In this case, there is no way how the consumer-voter could discriminate between specific elements of the regulatory system from which he wants to "exit". If he doesn't like the environmental laws of a specific jurisdiction but finds the tax laws quite attractive, he cannot merely exit from the environmental regulations and stay within the tax system. He may only choose to either exit or stay within the whole regulatory system with all its various elements. The reason for this lies in the fact, that the scope of application of public laws is, in principle, across the board determined according to the same jurisdictional principles based on citizenship (nationality principles), physical presence (territoriality principle) or effects within the territory (effects principle). In other words, as has already been emphasised above, regulatory systems must be regarded as bundles of public goods which are legally tied together by nation states which offer them to consumer-voters on a take-it-or-leave-it basis.[20]

Furthermore, governments offer various non-legal public goods the use of which is dependent upon physical presence within the territory. The use of public goods such as infrastructure, educational institutions or the court system does, in principle, require the physical presence of consumers within the jurisdiction. Exiting a regulatory system by physically moving out of the jurisdiction, therefore necessarily implies giving up the use of all non-legal public goods offered by that jurisdiction as well. So, moving out of the jurisdiction never implies an "exit" out of the regulatory system only. This must have an important impact upon the kind of choices with which consumer-voters are confronted in the context of regulatory competition. They must always balance all the pros and cons

[20] See for a model of unbundling and regrouping regulations on a non-territorial purely functional basis B. S. Frey & R. Eichenberger, *Competition among Jurisdictions: The Idea of Functional, Overlapping and Competing Jurisdictions (FOCJ)*, in: L. Gerken (ed.), *Competition among Institutions* (Basingstoke, Hampshire, 1995), 209-229.

regarding the full set of legal and non-legal public goods offered by the different jurisdictions before making a rational choice according to their preferences.

Regulatory competition can therefore rarely be perfect with regard to specific regulations. The bundling problem causes an "exit" to have much broader implications. In principle, governments tend to offer regulations by tying a large number of public goods together, including even non-legal public goods such as infrastructure (roads, public transportation, educational institutions etc.). In most cases, therefore, consumer-voters using the "exit" strategy have only one option: either accept or reject the whole bundle of regulations (public goods). Only in a limited number of cases are they allowed to opt out of the application of specific regulations only.

IV. Parametric Interdependence

For competition to work properly, it is indispensible that suppliers of goods or services have an incentive to adjust their production decisions to the preferences of consumers as revealed by the latters' demand for specific goods and services. In other words, workable competition presupposes that actors on both sides of the market are mutually interdependent in terms of their reacting to changes of any one of the parameters of competition (such as prices, quantities, qualities etc.). This means that in our present context, governments should be able and willing to modify and adjust their sets of regulations to any change of consumers' demand for such regulations. If consumers increasingly opt for an "exit" strategy, governments should be able and willing to react swiftly by improving national regulations so as to make their set of public goods more attractive. Arguably, therefore, the interjurisdictional "exit" strategy, in order for it to lead to better regulation, must have a similar impact upon governments as an internal democratic "voice" strategy. There is a clear but very complex interdependence between interjurisdictional regulatory competition and internal political competition.[21]

Although one can observe that governments, in some areas of regulation, are indeed sensitive towards the migration of persons or firms out of their jurisdiction, the general impression is that governments are rather slow in picking up with developments resulting from interjurisdictional regulatory competition. Considerable rigidities in the political process seem to prevent the degree of regulatory flexibility of governments that would be necessary for a fully workable interjurisdictional competition. More importantly, the freedom of national governments to change national regulations is limited by the path-dependency of national legislation. The possibilities of emulating "better" foreign regulations or of "inventing" new answers to regulatory problems are always limited by the exigencies of compatibility of new regulations with the existing legal institutions.

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[21] This point has been correctly emphasised by M.E. Streit, *Systemwettbewerb im europäischen Integrationsprozess*, in: U. Immenga, W. Möschel & D. Reuter, *Festschrift für Ernst-Joachim Mestmäcker* (Baden-Baden, 1996), 521-535.

V. Market Failures

Regulatory competition, in order for it to operate efficiently, is, in principle, subject to the same requirements as any market competition. In other words, interjurisdictional competition should ideally not suffer from market failures.

Firstly, there should be no informational asymmetries. Both sides of the market for regulation should be fully informed. Consequently, there must be full transparency of all competing regulatory systems. On the demand side, consumers and firms should know the sets of public goods (legal as well as non-legal) from which they may choose. They should be able to make a rational cost-benefit analysis of all "exit" and "entry" options. On the supply side, governments should know what other jurisdictions offer in order to be able to react in due course of time.

Secondly, regulatory competition should not cause interjurisdictional externalities. All jurisdictions should internalise the costs and benefits of their regulations. Most importantly, no national government should regulate at the expense of other jurisdictions or free-ride on the regulations of foreign states.

And, thirdly, public goods which are offered by a national government within the jurisdiction, which reflect the preferences of the electorate of this jurisdiction and which are "financed" by the people within this jurisdiction should not be accessible to outsiders. In other words, in order to exclude free-riding, national public goods should ideally be subject to a regime of exclusionary rules (these would represent interjurisdictional property or liability rules).

VI. Workability of Regulatory Competition

The foregoing analysis has demonstrated that regulatory competition is confronted with a number of problems: There is no full interjurisdictional mobility of consumer-voters. There are serious informational problems on the supply side as well as on the demand side of the market for regulations which limit the potential for rational choice of consumer-voters as well as the governmental adjustments to interjurisdictional competition. Regulatory adjustments are subject to the requirement of compatibility with existing institutions and they are path-dependent. The choice of consumer-voters is to a large extent not between individual regulations but between whole bundles of different regulations and of non-legal public goods. Economic and political competition are inseparably intertwined when it comes to governmental regulation but they function in very different ways. All these various aspects indicate that regulatory competition may suffer from high transaction costs and, last but not least, market failures.

In light of these considerations, there is agreement today that regulatory competition cannot possibly be perfect. The *Tiebout* model is what it is: a model that is useful for analytical purposes but not a description of what happens in reality. There is disagreement among law & economics experts, however, as to the degree of workability of such competition.[22] Evolutionary economists tend to take a more positive view than those who adhere to pure neoclassical and welfare-economic analysis.

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[22] See for a most comprehensive selection of papers presenting various conflicting views W. Bratton, J. McCahery, S. Picciotto & C. Scott (eds.), *International Regulatory Competition and Coordination – Perspectives on Economic Regulation in Europe and the United States* (Oxford, 1996).

The limitations to interjurisdictional mobility, the bundling problem, the transaction costs involved in the informational problems on both the supply and the demand side of the market for regulations, the interconnectedness of economic and political competition and the rigidities of the political process which are responsible for the low speed of institutional adjustments and innovations and, last but not least, even the potential for market failures are not of decisive concern from the point of view of evolutionary economics. From an evolutionary perspective, regulatory competition is in principle at work for the benefit of consumer-voters. Governments (regulators) are at any rate subject to interjurisdictional competition and they will therefore continuously endeavour to produce innovative public goods (in particular: regulations) in order to offer increased benefits to consumer-voters who may want to "use" such regulations. Other jurisdictions will try to imitate these innovations if they consider them to be superior solutions. Regulatory competition is therefore said to provide an incentive to regulators to continuously improve regulations so as to better meet consumer-voters' preferences. The competitive evolution of regulatory institutions is seen as a process of trial and error which leads to the selection of ever better solutions to regulatory problems ("race to the top"). At the same time, regulatory competition is said to turn governmental monopolies into contestable markets, thereby exposing governmental regulation to the test of international acceptance and reducing the risk of regulatory capture.[23]

Other economists who are not, in principle, denying the evolutionary character and the beneficial effects of regulatory competition, are however more carefully acknowledging the potential for certain negative effects. *Sinn* has expressed his skepticism in the following terms:[24] "Because the state is a stopgap which fills the empty market niches and corrects the failures of existing markets, it cannot be expected that the reintroduction of the market by the back door of regulatory competition will lead to a reasonable allocation result. Instead, it must be feared that the failures that originally caused the government to take action will now show up again at the higher level of government competition." Indeed, it can hardly be denied that interjurisdictional mobility of consumers may in fact undermine certain national regulations that are designed to enhance efficiency by eliminating market failures or that legitimately pursue goals of distributional justice. To the extent that the "exit" option allows consumers in one jurisdiction to avoid the costs involved in the elimination of market failures by domestic regulation and to shift these costs to nationals of foreign jurisdictions with no equivalent regulation, interjurisdictional competition may undermine the more efficient domestic regulations and lead to an inefficient "race to the bottom". If, for instance, child labour is prohibited in jurisdiction A, but not in jurisdiction B, the import from B into A of cheaper goods produced in B by the use of child labour may trigger an exit of producers of these goods from B to A and a potential lifting of the prohibition of child labour in jurisdiction B. Such "race to the bottom" is inefficient, because it eliminates regulations which are designed to internalise externalities. *Sinn*[25] has identified as one of the major negative results of regulatory competition, among others, the erosion of the social welfare system, a system that according to him deals with a market failure which is due to the incapability of markets to provide insurance for unknown future life and employment risks. The same reasoning would apply

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23 See H. Siebert & M. Koop, *Institutional Competition Versus Centralization: Quo Vadis Europe*, Oxford Review of Economic Policy 9 (1993), 15-30.

24 H-W. Sinn, *The New Systems Competition*, supra footnote 6, at 6.

25 Ibid.

to regulations that pursue distributional goals. *Streit*, on the other hand, has argued that the limits to regulatory competition resulting from the interdependence of economic and political competition operates against the erosion of distributional institutions.[26]

D. The role of harmonisation

Harmonisation or coordination of diverging national regulations is tantamount to centralisation or monopolisation of the jurisdiction to regulate. This implies, by definition, the elimination of regulatory competition. On a purely conceptual level it is safe to say that centralised regulation, like any regulation, may be warranted for efficiency reasons whenever it is necessary to avoid inefficiencies resulting from market failures of regulatory competition. Clearly, the interjurisdictional market for regulations may suffer from failures for exactly the same reasons that lead any market to fail under certain circumstances.

Firstly, regulatory competition may be inefficient due to "informational asymmetries". It may not at all be easy for consumers of different sets of governmental regulations to properly assess their quality so as to be able to make a rational choice in favour of the most attractive set. On the other hand, the market may well be able to overcome such informational problems by means of professionals (lawyers) who specialise in selling legal information. Then what may appear at first sight as a market failure, simply turns out to be a transaction cost. A good example is the choice of the incorporators of a company between various national company law systems. From a continental perspective, English company law may look most attractive, because for private companies there are no minimum capital requirements. On the other hand, there are serious liability risks for companies' directors under English company law that may well outbalance the absence of a minimum capital requirement. Incorporators may hire lawyers in order to assess the pros and cons of competing company law systems. Another way of dealing with informational transaction costs may well be the harmonisation of laws.

Secondly, regulatory competition may give rise to "externalities" wherever resources are used internationally (such as the air or the sea). Low environmental standards in one jurisdiction may have serious negative effects on the environment of another jurisdiction even if the latter applies much higher standards. Also, high environmental standards in one jurisdiction may invite free-riding by other jurisdictions. Consequently, regulation on a supranational level may be warranted which harmonises environmental standards so as to avoid interjurisdictional "externalities".

Finally, governments may produce public goods that display interjurisdictional economies of scale. This is the case whenever it is cheaper to provide a public good for more than one single jurisdiction. A case in point may be the supply of a supranational currency which leads to a reduction of transaction costs for market transactions. Again, supranational legislation may be required.

In sum, the elimination of "informational asymmetries", the internalisation of "externalities" as well as the production of supranational public goods may therefore justify harmonisation, coordination and centralisation of governmental regulations on a supra-

[26] M. E. Streit, supra footnote 21, at 531.

national level (regional or even worldwide).[27] The efficiency gains from harmonisation must be balanced, however, against the costs of centralisation. They consist, first of all, in a loss of flexibility for regulatory innovation which is due to the stickiness of centralised political and legislative procedures. The dynamic efficiency of regulatory competition may therefore be negatively affected. Regulatory centralisation also aggravates the problem of aggregating a much larger number of preferences of consumer-voters into one single supranational collective preference for a specific public good. The problem of regulatory capture may be also be aggravated, because well organised national interest groups may establish powerful international coalitions whose lobbying activities are then targeted at one single regulatory authority. Finally, due to the larger distance between customer-voters and a central legislative body, centralised regulation may be confronted with much more serious principal-agent problems than decentralised regulation.

As may be expected, there is fundamental disagreement among experts of regulatory competition as to the cost/benefit balance of regulatory harmonisation and centralisation. This disagreement is clearly just the flip side of the disagreement about the efficiency of regulatory competition. Those who are optimistic enough to believe that regulatory competition is, in principle, a "race to the top", are downplaying the potential for failures of the market for regulations and, consequently, the proper role of harmonisation and centralisation. Those who are more sceptical in this regard, tend to favour quite logically to some degree harmonisation and centralisation of governmental regulation. At the end of the day, all available analyses of the pros and cons of regulatory competition in terms of its efficiency effects are far from being fully conclusive. Much more theoretical and empirical research is needed before sweeping conclusions may be drawn. Nevertheless, the law & economics approach to regulation provides us with a very powerful analytical tool which allows us to ask the right questions. We should only be careful to answer these questions without further in depth analyses of the various interdependent mechanisms that operate in favour or against a workable regulatory competition.

E. Conclusion

The law & economics perspective sheds much light on the nature, the function and the limits of economic regulation. It applies the market paradigm, in particular the neoclassical microeconomic analysis, to legal institutions. It is able to explain the indispensability of "enabling laws" which are the institutional foundation of markets, as well as of "correcting regulations" which are designed to eliminate market failures (informational asymmetries, externalities, provision of public goods) by intervening in market transactions. Both sets of laws and regulations are necessary in order to allow markets to operate efficiently, i.e. to adjust economic activities to the preferences of consumers. Beyond efficiency goals, states are also justified to pursue distributional objectives (social justice), provided they are in compliance with the revealed preferences of the population. Since any regulation is the result of public legislation, it also suffers from certain failures (regulatory failures) that are typical for the political process. The law & economics approach

[27] See for a detailed analysis of this problem with regard to various types of regulations H-W. Sinn, *The New Systems Competition*, supra footnote 6.

therefore calls for a balancing of all positive and negative effects before regulation should be put into place.

Regulation may be regarded as a public good which is supplied by governments to consumer-voters within the framework of nation states. To the extent that consumer-voters may either use their voting power ("voice" strategy) or leave the jurisdiction ("exit" strategy) in order to reveal their dissatisfaction with a prevailing set of regulations, regulators (governments) are subject to "regulatory competition". Interjurisdictional regulatory competition presupposes mobility of consumer-voters. For this competition to be efficient, the same requirements should, in principle, be satisfied that are applied to any market (low transaction costs, absence of market failures, parametric interdependence). However, interjurisdictional competition suffers not only from limits to consumer-voters' mobility as well as from the problem of bundling and the rigidities of legislative processes which limit the parametric interdependence. It also suffers from high transaction costs and the potential for market failures. Consequently, the balance of positive and negative effects of regulatory competition is highly disputed.

Harmonisation in the sense of an "ex-ante" harmonisation by way of supranational legislation is justifiable from a law & economics perspective only where it is necessary to eliminate market failures of interjurisdictional competition. The existence of such market failures is also highly disputed, however. There is consensus that regulatory competition cannot possibly be perfect. On the other hand, according to the prevailing view, interjurisdictional regulatory competition is a fact. States have very different views on the respective roles of governments and markets, on the preferable mix of "enabling laws" and "corrective regulations" as well as on the role of economic efficiency and distributive justice. These different views are increasingly subject to pressure from interjurisdictional competition. Slow as this competitive process may be, it may be conceptualised as a "process of discovery" which in spite of its limitations leads, by trial and error, to the continuous improvement of our regulatory institutions ("race to the top"). However, this process is, according to some observers, also fraught with certain deficiencies that may lead to an erosion of national regulations which are designed to either eliminate market failures or pursue legitimate distributive objectives ("race to the bottom"). Such deficiencies may warrant supranational regulation (harmonisation) in relevant areas. But before conclusive answers may be given to these problems, far more theoretical and empirical research is needed.

Economic Constitution, the Constitution of Politics and Interjurisdictional Competition

Viktor J. Vanberg[*]

There is a growing consensus in economics that the most powerful explanatory variable in accounting for the differences in economic performance across societies is the "quality" of the institutional framework that defines the "rules of the economic game" or, in other terms, the "economic constitution" (Olson 1996). Theoretical reasons (Hayek 1973: 107 ff.) as well as systematic empirical evidence (Gwartney et al. 2007; Heritage Foundation 2007; Messick 1996; Hanke and Walters 1997) unambiguously indicate that rules and institutions that protect property rights and facilitate trade – in short: the institutions of markets – provide incentives for productive activity and are conducive to the creation of wealth, while the lack of such rules and institutions is an impediment to economic performance.

Since, other things being equal, it is surely preferable to live in a prosperous rather than in a poor society, an economic constitution that promotes the creation of wealth can be assumed to serve the common constitutional interests of all members of a polity.[1] Accordingly, one might expect such an economic constitution to enjoy broad political support. There is, however, ample evidence to the contrary. Rather than being politically robust, the constitutional foundations of market economies seem to be notoriously vulnerable to gradual erosion. This paradoxical phenomenon calls for an explanation.

There are two principal reasons why the political process may produce policy measures and legislation that undermine the constitutional foundations of a market economy and thereby erode a society's wealth-creating potential. The first has to do with the "knowledge problem", i.e. with the fact that the causal link between rules and institutional provisions on the one side and the resulting patterns of economic outcomes on the other side is by no means obvious and easy to recognize. Choices in politics are between "blueprints", between proposals for rules and legislative measures that are conjectured to result in desirable outcome patterns. Adequately to judge the soundness of such conjectures requires a sufficient knowledge of the factual working properties of rules and institutions, a kind of knowledge that cannot be supposed to be always present either among citizens who vote on political programs, or among politicians who decide, as the citizens' agents, on legislative project.

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[1] The term "constitutional interests" refers to the interests that inform people's preferences when faced with the (hypothetical or real) choice among potential alternative institutional regimes under which they are to live. "Common" constitutional interests are preferences for constitutional regimes on which all members of a constituency can agree, by contrast to interests in privileges, i.e. preferences for rules that grant special advantages to particular individuals or groups at the expense of other members of the constituency (see Vanberg 2005).

The second principal reason for the vulnerability of markets has to do with the special-interest problem, i.e. with the fact that, even though a wealth-creating economic constitution is in citizens' common constitutional interest, there are incentives for individuals and special-interest groups to seek, via the political process, the adoption of rules and regulations that grant special privileges to them at the expense of other members of society, thus reducing overall wealth. Such privilege-seeking or rent-seeking has its foremost source in the protectionist interests that people harbor in their capacity as producers. While they share in their capacity as consumers a common interest in an economic constitution that facilitates trade and promotes competition, in their capacity as producers citizens prefer protectionist regulations and subsidies that benefit their particular trade, even if such preferential treatment reduces society's overall wealth. A wealth-promoting economic constitution can, in this sense, be regarded as a social contract: Citizens agree to accept, in their capacity as producers, the burden of competition in order to jointly benefit, in their capacity as consumers, from the productivity of a competitive system. However, as with all social contracts, the fact that they promise mutual gains to the parties involved is not sufficient to ensure compliance. Effective enforcement is needed in order to keep contractors from succumbing to the temptation to exploit opportunities for private gains that come at the other parties' expense.

A society's prospects for the sustained creation and maintenance of economic prosperity depend on its capacity to deal successfully with the two noted problems, the knowledge problem and the rent-seeking or privilege-seeking problem. This capacity, in turn, depends on the presence of suitable "rules for the game of politics" or, in other terms, on the presence of a political constitution that, on the one side, provides incentives for and facilitates "better informed" choices on the part of voters and political agents and, on the other side, reduces the incentives and opportunities for rent-seeking. What is required is an effective institutional framework that constrains the political process in ways that facilitate the implementation of citizens' common constitutional interests and reduce the risk of poorly informed policy choices as well as the potential for privilege-seeking and privilege-granting.

To provide for such an institutional framework is, in the first instance, the task of national political constitutions. The present context is not the place to comment extensively on the attributes of national constitutions that tend to make them effective in the noted sense. What is worth stressing, though, is the important role that a functioning federal structure and a competitive federalism can play in coping with the knowledge problem as well as with the rent-seeking problem. Analogous to the manner in which competition in markets serves as a knowledge-creating discovery procedure (Hayek 1979, 67 ff,) and as an incentive mechanism that disciplines producers to the benefit of citizens, competition in politics – and, in particular, a competitive federalism – can serve as a mechanism that generates information about the working properties of alternative rule-regimes as well as incentives for political agents to be responsive to citizens' common interests (*Vanberg* 2001).

Because the principal threat to a society's wealth-creating potential originates from intra-national conflicts if interests, namely the conflicting interests in special privileges that citizens harbor in their capacities as producers, national political constitutions provide the first and natural "tool" for dealing with the knowledge problem and the rent-seeking problem. Yet, as a supplement to the provisions of national constitutions, the inter-national dimension of politics provides important additional opportunities for constraining national politics in ways that promote citizens' common constitutional interests and limit the scope for rent-seeking and privilege-granting. International provisions can

help to support the force of national constitutional provisions in two principal ways: Through international commitments that impose *formal* constraints on the authority of national governments and through interjurisdictional competition that imposes *factual* constraints on their discretionary powers.

International commitments, as they are entailed, for instance, in international treaties or in a country's membership in organizations such as the WTO, impose disciplining constraints on national governments by taking certain issues out of the dynamics of logrolling politics, and by doing so they can serve to bind governments and legislators in ways that allow them better to resist the pressure of special-interest groups.

For the same reasons that were discussed above with regard to the intra-national functions of a competitive federalism, interjurisdictional competition more generally can help to strengthen the force of national constitutional provisions. Interjurisdictional competition can help to remedy the knowledge problem in two ways. First, in its function as "yardstick-competition" it facilitates the comparison between the working properties of alternative institutional regimes. Second, and more importantly, it provides opportunities for individual choices among such alternative regimes, choices that differ in two relevant respects from collective political choices among legislative "blueprints". In case of the latter, the incentives as well as the capacity of individual citizens to make well-informed choices are reduced, first, because they can only vote on legislative proposals based on uncertain expectations about their actual merits and, second, because with their vote they can only co-determine a collective choice the outcome of which is only insignificantly affected by their own choice. By contrast, when individuals choose for themselves among alternative jurisdictions such choices are made in light of the observable actual working properties of the respective rule-regimes, and the benefits as well as the costs of a more or less "prudent" choice are fully born by the choosing individuals themselves.

Interjurisdictional competition imposes factual constraints on the capacity of national governments and legislators to grant privileges to special-interest groups for two reasons. First, granting privileges to particular groups necessarily means to impose the burden of alimenting such privileges (e.g. by higher prices in case of protectionist privileges or by higher taxes in case of subsidies) on others. The parties who are burdened with the costs of privileges granted to others have incentives to seek to escape such burden and, where possible, to use the exit-option, thereby diminishing the source from which privileges can be supported. Second, interjurisdictional competition provides citizens-voters with a "yardstick" to compare the economic performance across jurisdictions, providing incentives for reelection-seeking politicians to reduce their reliance on privilege-granting and to increase their efforts at implementing a wealth-creating "economic constitution."

The effectiveness of interjurisdictional competition as a knowledge-generating mechanism and as a disciplining constraint on the power of governments obviously depends on the ease with which persons and their resources can move across borders or, in other words, it depends on the costs of exit from one jurisdiction and the opportunities for entry into other jurisdictions.[2] The ease of border-crossing mobility depends, in turn, on the

[2] A more detailed discussion of this issue would need to consider the difference between two roles or capacities in which states operate. On the one hand, as joint enterprises of their citizens-members, they serve as the organization that produces those "collective goods" that the citizenry chooses, via the political process, to provide for itself. On the other hand, states operate as "territorial enterprises" that mobile persons and resources can use for their business and whom the host-state can charge a price for the right to benefit from the advantages (legal order,

extent to which national and international rules and regulations inhibit or facilitate such mobility. National and international institutional provisions that affect the transaction costs of border-crossing movements of persons and resources are in this sense a critical determinant for a society's capacity to alleviate the above-mentioned knowledge and special-interest problems.

As indicated, the effectiveness of interjurisdictional competition depends on the freedom of movement of persons and economic resources across national borders, and such freedom depends, in turn, on national rules and international commitments for its protection, rules and commitments that are subject to political choice. Reversely, the capacity of, and the incentives for, national governments and legislators to implement such rules and commitments depend on their power to resist the pressure of privilege-seeking interest groups, and such power is, in turn, a function of the effectiveness of interjurisdictional competition. In this sense there exists a significant interdependence and synergetic relation between a society's economic and political constitution, its international commitments and interjurisdictional competition. A political constitution that is conducive to solving the knowledge problem and the special-interest problem helps to maintain a competitive and productive economic constitution. Reversely, an economic constitution that provides for a competitive and open economy imposes constraints on the political process that make for better informed policy choices and curb the potential for privilege-granting and, consequently, the incentives for privilege-seeking.

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infrastructure, qualified labor force, etc.) that the jurisdiction has to offer. The ways in which persons can use the exit option to escape unwanted policies are obviously different, dependent on whether they concern their relation as citizen to the state as joint enterprise or their relation as a "jurisdiction-user" to the state as a territorial enterprise.

Assessing the Impact of Economic Law

Erich Schanze[*]

A. The Problem of Institutional Impact

Commenting on the impact of economic law on the structure of state and society is an ambitious task. It seems to imply a well defined subject matter, the effect or influence of which is to be assessed by establishing testable hypotheses. There is little consensus on the "nature" and scope of economic law. Moreover, the "technology" of "measuring" impact of legal institutions is, at best, in a state of infancy.[1]

As I will show there are various levels on which impact of legal institutions can be analyzed. On the macro-level there is a tradition of more or less conclusive restatements of the "rise and fall" of states, societies and economies. These grand theories are typically associated with a more or less explicit ideological bent – from Gibbon to Spengler, and most recently de Soto[2] and La Porta et al.[3] Although these analyses and statements expose different degrees of plausibility, they are typically painted with a broad brush.

On a micro-level the analyses are less vexing. Obviously, closely defined case studies are much safer in terms of testable hypotheses, but the isolation of the narrow field of analysis has a price. The studies sometimes demonstrate the obvious and do not account for the "embeddedness" of the impact of a certain isolated institutional arrangement. Done from a comparative angle, these micro studies may reveal, however, the operation of institutions in their specific context.

In these remarks I will briefly survey two issues which might give some guidance for future "impact studies". Firstly, I will try to clarify the problem of the "production" of economic law and the underlying conceptual problems on the level of legal theory. Secondly, I will slightly modify the original question by taking up an economic perspective and by asking how economic actors assess the impact of economic law in practice.

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[1] See the critical assessment by B. du Marais/P.-H. Conac/A. Piquemal/P. Frouté, *Rating the Law: How Financial Rating Agencies are Assessing the Legal Risks of Financial Transactions*, in: P. Nobel/M. Gets (eds.), *Law and Economics of Risk in Finance* (Zürich, 2007), 15-34.

[2] H. de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York, 2000).

[3] R. La Porta/F. Lopez-de-Silanes/A. Shleifer/R. Vishny, 1998, *Law and finance*, Journal of Political Economy 106, 1131-1150; R. La Porta/F. Lopez-de-Silanes/A. Shleifer, 2006, *What Works in Securities Law?*, Journal of Finance 61, 1-31.

In this context I will specifically point to a number of ongoing studies which try to assess or even measure the impact of legal institutions, and finally turn to the promising field of industry/country studies.

B. Understanding Impact: Economic Law as Intervention or Interaction?

I. Introduction

The study of economic law resembles looking through a kaleidoscope. In the mid-seventies we were confronted with the prevailing definition that the core of economic law is state intervention in "the" economy, the economy being understood as a part of "society".[4] If it were as simple as that it should be easy to study the "impact" of state intervention. This is obviously not the question which *Karl Meessen* presented to the panel discussion. He asked us how "economic regulation" affects the structure of state and society. Obviously, this presupposes that both aggregates "state" and "society" are in a flux, and that they are eventually influenced by economic law.[5]

II. The problems of an interventionist conception of economic law

Understanding economic law as intervention, or top-down ordering, is largely empty because it does not address two problems:

1. the political potential of *both* aggregated *actors*, the state and the economy (as part of "society");
2. the limited *knowledge* of the legislator concerning the design and the effects of economic regulation.

When we looked at the institutional setting of German economic law in the mid-seventies we realized that economic law can only be understood within a process of *mutual* "interventions" of the state and the organized economic actors in the pluralist democratic nation state.[6] Today we would diversify the notion of the "state" by looking at three relevant centres of decision making: the nation state including the infra statal level, the supra-national community level, and the more visible level of international organisations and processes.[7] *Karl Meessen* has addressed the two-sided nature of economic law nicely by speaking of an "institutional duality" of "state-made" law with "business-made" ingredients.[8]

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4 This was the basis of the standard German treatment of "Wirtschaftsrecht" up to the 70's; see e.g. G. Rinck, *Wirtschaftsrecht*, 5th ed. (Cologne, 1977).

5 H.-J. Mertens/C. Kirchner/E. Schanze, *Wirtschaftsrecht*, 2nd ed. (Opladen, 1982); K. Meessen, *Economic Law in Globalizing Markets* (The Hague, 2004); M. Ortino, *The Notion of Economic Law and Regulatory Competition*, this volume, p. 103-114.

6 H.-J. Mertens/C. Kirchner/E. Schanze, *Wirtschaftsrecht*, 2nd ed. (Opladen, 1982).

7 See the impressive analysis of K. Meessen, *Economic Law in Globalizing Markets* (The Hague, 2004), 28-52.

8 K. Meessen, *Economic Law in Globalizing Markets* (The Hague, 2004), 90.

III. Two basic schools of thought

The controversy of "intervention" versus "interaction" in economic law seems to relate to two basic (simplified) schools of thought.

1. Constitutionalism

The constitutional school starts from the *Hobbes*ian view of the function of the state. Order and intervention is needed as a limitation of unlimited antagonistic civic action. In this perspective state and society are divided by their respective functions. Constitutional rules are required for establishing and defining state intervention.[9] Hence, constitutionalism, by definition, has a bent towards policy making/law making by state intervention. It also supports, or is loosely associated with, the public law /private law divide common in continental legal thinking.

2. Microconstitutionalism

This school of thought starts from the premise of rule-making in overlapping spheres of "state" and "society". It looks at the "practices" of rule-making and rule-observation, mainly from the viewpoint of "costs" and "benefits" of institutions (*Coase*).[10] A reasonable tool of analysis is the study of institutional survival (*Alchian*).[11] This implies a shift of the perspective from the choice of orders by the ideal policy-maker to an analysis of the choices of both the state and the individual economic "actors". It takes the perspective of economic agents who might be seen – in this sense – also as "private" policy-makers.

In contrast to the "interventionist" concept of economic law, this school of thought is interested in both public and private law-making. Of course, it also has to answer a "constitutional" question on a general level: What are the boundaries of private law-making and institution building, influencing public law-making?[12] What are the links

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[9] Cf. E.g. J.M. Buchanan, *Constitutional Economics*, in: J. Eatwell/M. Milgate/P. Newman (eds.), The New Palgrave (London, 1991), 585-588; V. Vanberg, *Der individualistische Ansatz zu einer Theorie der Entstehung und Entwicklung von Institutionen*, in: Jahrbuch für Neue Politische Ökonomie (1983), 50-69; id, *Economic Constitution, the Constitution of Politics and Interjurisdictional Competition*, this volume, p. 61-64; S. Voigt, *Constitutional Political Economy* (Cheltenham, 2003).

[10] R. H. Coase, *The Institutional Structure of Production*, American Economic Review 82 (1992), 713-719; E. G. Furubotn, R. Richter, *Institutions and Economic Theory* (2nd ed Tuebingen 2005); E. Schanze, *Rechtsnorm und ökonomisches Kalkül*, Journal of Institutional and Theoretical Economics 138 (1982), 297-312.

[11] A. A. Alchian, *Uncertainty, Evolution, and Economic Theory*, Journal of Political Economy 58 (1950) 211-221;see also L. Gerken, *Institutional Competition: An Orientative Framework*, in: L. Gerken (ed.), *Competition among Institutions* (Suffolk, 1995) 1-31.

[12] E. Schanze, *Die Entwicklung von Institutionen*, in: C. Meier-Schatz (ed.), *Die Zukunft des Rechts* (Basel, 1999) 195-206.

to law?[13] Obviously, there is also a need for overarching institutional design controlling these "private" choices. But the starting point is an analysis of incentive compatible contracts/constitutions[14] between private actors within a certain (national/international) legal setting, which is not "given", but rather an ongoing process driven by the interaction of state and economy. The channelled interaction of law making involves both policy formulations and a mutual learning about the relevant issues.

I am representing the second school of thought maintaining that the "micro" design of transactions, and to a lesser degree, the overarching institutional design on a constitutional level, is at the centre of motivating state and private actors.[15] My starting point is the analysis of incentive compatible contracts and organisations as the blueprints of "constitutional" issues and as the "defaults" for grand institutional design.[16]

The inputs for regulation /economic law do not come from heaven. They are typically the result of an interaction of public and private policy makers who both compromise on certain policy goals. This is the key difference to classical "private law" which is a durable intellectual structure for ordering private transactions, starting from the basic legal concepts of property and contract.[17] For the "purposive", policy-oriented regulation, which may be partly *ad hoc*, the principal mechanism of ordering is, of course, *law making,* typically by representative political bodies. But there are two important alternative basic mechanisms allowing discretionary action: *delegation to agencies* (prominent examples: central banks, competition authorities, regulatory agencies in specific markets) and

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13 E. Schanze, *International Standards: Functions and Links to Law*, in: C. Bruetsch/D. Lehmkuhl (ed.), *Law and Legalization in Transnational Relations* (Oxford, 2007) 166-184.

14 A. T. Kronman/R. A. Posner, *The Economics of Contract Law* (Boston, 1979); R. Craswell/A. Schwartz, *Foundations of Contract Law* (New York, 1994); V. P. Goldberg (ed.), *Readings in the Economics of Contract Law* (Cambridge, 1989); Y. Barzel, Economic Analysis of Property Rights, 2nd ed. (Cambridge, 1997); J. Tirole, *The Theory of Corporate Finance* (Princeton, 2006).

15 E. Schanze, *Die Entwicklung von Institutionen*, in: C. Meier-Schatz (ed.), *Die Zukunft des Rechts* (Basel, 1999) 195-206.

16 R. J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing,* Yale Law Journal 94 (1984), 239-256; id., *Law and Economics in the Law Firm: The Case of MACs*, in: P. Nobel/M. Gets (eds.), *New Frontiers of Law and Economics* (Zürich, 2006), 171-180; E. Schanze, *Legalism, Economism, and Professional Attitudes Toward Institutional Design*, Journal of Institutional and Theoretical Economics 149 (1993), 122-140; related – in a top down perspective – is the idea of a substitution between law enforcement by courts and by regulators in a theory of "incomplete law" in a recent series of papers by Katharina Pistor (Columbia) and Chenggang Xu (London): see K. Pistor and C. Xu, *Incomplete Law*, Journal of International Law and Politics (2008, forthcoming).

17 In this context I do not understand „private law" as the comprehensive subject matter contained in civil codes, such as e g the French code civil or the German BGB but only those matters related to the "general part", i.e. the basic rules of property and contract law which are largely homogeneous around the globe.

regulation by consensus, i.e. contracting between the state and private agents.[18] Moreover, self-regulation of the economy features prominently.[19]

In globalizing markets *jurisdictional choice* and associated jurisdictional competition play an increasing role.[20] Trade regimes and investment regimes are selected as if they were "goods". Large or politically important "foreign" investments are attracted by offering "special terms" which challenge a central structural feature of law: its generality.

C. The Drafting Perspective: How do Policy Makers, Including Economic Actors, Assess the "Impact" of Economic Law?

For understanding the impact of economic law from an actor perspective, the key issue is the forecast and the evaluation of consequences of regulation in a specific trade or investment context.

I. Impact assessment in the legislative process

Lawyers typically confine themselves to look whether a law is "applicable". They seem to have a surprising disinterest in the effects of institutions.[21] We know the routine allegation in the legislative materials of new German statutes that the forthcoming regulation does not cause any costs. There is a lot of guesswork, prophecy and even data manipulation, in better cases a limited access to uncontested data, and in rare instances at least a "bad conscience", signalled by the use of sunset laws (which are routinely prolonged). The impact of a given piece of legislation is typically assessed in terms of plausibility, mostly using data or projections provided by the lobby. Attractiveness of the issue for the median voter plays a significant implicit role. It is noteworthy in Germany that we see, in increasing scope and relevance, delegations of economic law-making to specialized law firms. Examples are capital market statutes where the ministries obviously feel a lack of manpower and expertise. Law firms are also increasingly asked to comment on specialist draft legislation. But the task is not so much the assessment of the costs/impacts of the measures but rather a prognosis about the workability of the new laws.

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18 E. Schanze, *Investitionsverträge im internationalen Wirtschaftsrecht* (Frankfurt am Main, 1986); id. *Regulation by Consensus: The Practice of International Investment Agreements*, Journal of Institutional and Theoretical Economics 144 (1988), 152-171.

19 I have tried to elaborate this point recently in E. Schanze, *International Standards: Functions and Links to Law*, in: C. Bruetsch/D. Lehmkuhl (ed.), *Law and Legalization in Transnational Relations* (Oxford 2007) 166-184; also in a specific field see G. Ferrarini, *Contract Standards and the Markets in Financial Instruments Directive (MiFID): An Assessment of the Lamfalussy Regulatory Architecture*, European Review of Contract Law 1 (2005), 19-43.

20 R. Vernon, *Sovereignty at Bay* (New York, 1971); K. Meessen, *Economic Law in Globalizing Markets* (The Hague, 2004) 254seq. L. Gerken, *Institutional Competition: An Orientative Framework*, in: L. Gerken (ed.), *Competition Among Institutions* (Suffolk, 1995) 1-31.

21 But see the careful observations on the perspective of the European Court of Justice: D. Edward, *Economic Law as an Economic Good: Reflections of a European Judge*, this volume, p. 91-100.

II. Impact assessment in legal consulting in the business context

In business practice legal consultants give occasionally, under limited circumstances, advice on potential costs and benefits of institutions. These are typically raw estimates based on experience.

An example may be the choice of the "anchoring" of a new financial issue, say a hedge fund. Here the "cheapness" of an offshore jurisdiction, say the Cayman Islands, is balanced against "costlier" jurisdictions, say, Luxemburg or England (London) which may have a better reputation.[22] This is done in, partly extensive, memos. On request, legal costs, administrative fees, and taxes are specified in money terms. The accounting process sometimes needs data on the value of liabilities which include aspects of "institutional" risks.[23] "Indices" on investment climate[24] are still rarely used by the legal profession.[25]

III. Impact assessment as a task of (institutional) economics

Technical assessments of cost and benefits of institutions are typically thought to be a task for economists who act as appointed or self-appointed policy advisors.

1. Case studies

The most convincing studies, using detailed statistical materials, relate to individual, highly specified impacts, such as

1. Effects of shop closing hours;[26]
2. Effects of tax levels in Swiss cantons;[27]
3. Delisting events after SOX.[28]

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[22] Of course, tax reasons for jurisdictional choice are paramount, and there may be technical "splits" of jurisdictions (e g UK law for the vehicle, Cayman Islands law for the issue), see C. Schmies, *Jurisdiction Selection for Investment Funds – Practical Considerations*, Paper presented at the Seminar on the Law of International Business Transactions Riezlern, 2008 (Ms.); P. Sester, *Projektfinanzierung als Gestaltungs- und Regulierungsproblem* (Cologne, 2004) for the choice of regimes for project finance.

[23] Particularly for entering reserves for legal risk in the annual balance. For pending cases attorneys are routinely asked to evaluate the outcomes of litigation.

[24] Below, footnote 3.

[25] Source: interviews with legal practitioners.

[26] E.g. R. Inderst/A. Irmen, *Shopping hours and price competition*, European Economic Review 49 (2005), 1105-1124; J. Rouwendal/P. Rietveld, *An economic analysis of opening hours for shops*, Journal of Retailing and Consumer Services 5 (1998), 119-128.

[27] E.g. L. Feld, *Tax Competition and Income Redistribution – An Empirical Analysis for Switzerland*, Public Choice 105 (2000), 125-164.

[28] A. B. Laby/J. Brussard, *The Competition of Systems in the Market for Listing*, this volume, p. 167-186; see also D. W. Arner, *The Competition of International Financial Centres and the Role of Law*, this volume, p. 193-210.

2. Investment climate studies, indices

On a more general or even global level we see presently innumerable "business climate" indices concerning the competitiveness of regimes.[29] Famous studies include

1. La Porta, Lopez-de-Silanes, Shleifer and Vishny (1997-2006): Financial Markets "Climate"[30]
2. World Bank: Doing Business[31]
3. The Investment Compass by UNCTAD[32]
4. World Competitiveness Yearbook by IMD.[33]

IV. Problems of current impact studies

How do these rankings in institutional assessment /business climate indices influence business decisions? Presently, hard economic factors such as market or resource access, labour costs, special skills, physical infrastructure, strategic location are still much higher on the agenda. The likelihood of major local disturbances, massive uncertainties in the sense of a Knightean risk analysis do, of course, matter. Tax and tariff considerations come next. The immediate legal framework in its enabling and restricting dimensions is mostly still regarded to be a "soft" factor. Moreover, the differences may be overcome either by "regulation by consensus" or, for example by "most favoured" treatments. Most likely, the institutional differences in "normal" industrial states are probably minor, if all effects in a given jurisdiction are accumulated.

It is remarkable in this context that the French legal community has recently commissioned a member of the Conseil d'Etat for establishing an academic program "Economic Attractiveness of Law".[34] The key reason was the negative (and flawed) treatment of France in two important "business climate index studies".

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29 On a website of a German business school (ESCP-EAP) I found a 2007 seminar schedule referring to 44 different "indices" on economic performance which were listed for potential student papers (www.escp-eap.de/Lehre).

30 R. La Porta/F. Lopez-de-Silanes/A. Shleifer/R. Vishny, *Legal determinants of external finance*, Journal of Finance 52 (1997), 1131-1150; R. La Porta/F. Lopez-de-Silanes/A. Shleifer/R. Vishny, 1998, *Law and finance*, Journal of Political Economy 106, 1131-1150; R. La Porta/F. Lopez-de-Silanes/A. Shleifer, 2006, *What Works in Securities Law?*, Journal of Finance 61 (2006), 1-31.

31 World Bank/International Finance Corporation, *Doing Business in 2004: Understanding Regulation* (Oxford, 2004); World Bank/International Finance Corporation, *Doing Business in 2005: Removing Obstacles in Growth* (Oxford, 2005); World Bank/International Finance Corporation, *Doing Business in 2006: Creating Jobs* (Oxford, 2006).

32 See http://compass.unctad.org.

33 See http://www.imd.ch/research/publications/wcy/wcy_online.cfm.

34 See C. Ménard/B. du Marais, *Can we Rank Legal Systems According to Their Economic Efficiency*, in: P. Nobel/M. Gets (eds.), *New Frontiers of Law and Economics* (Zürich, 2006), 7-27; B du Marais/P.-H. Conac/A. Piquemal/P. Frouté, *Rating the Law: How Financial Rating Agencies are Assessing the Legal Risks of Financial Transaction*, in: P. Nobel/M. Gets (eds.), *Law and Economics of Risk in Finance* (Zürich, 2007), 15-34.

The studies of the French team reveal a number of "systemic" shortcomings of the "indices" in the methodologies of La Porta et al. and the World Bank "Doing Business" Studies.[35] The desire for an economic quantification of institutional impact may lead to a cannibalisation institutional complexity. For the comparative lawyer it is standard to look at functional equivalents which sometimes arise in seemingly unrelated fields of the law. Moreover, the interplay between formal and informal rules and relevant enforcement mechanisms is hard to assess. Although the more recent studies of La Porta et al. consider some of these problems[36] they are still guided by a bias toward the "efficiency" of those laws which they obviously know best: those which are in the common law tradition. Whoever has been involved in the evaluation of legal outcomes and the vast interpretive problems of individual regulation is stunned by the confidence of these economist researchers who rely partly on one single country reporter – typically a practicing lawyer who has little training in the methods of comparative law but may have quite personal views on the efficiency of the legal system in which she or he are at home. Moreover, the dynamics of challenging existing regulation by offering new business solutions that appear, by first inspection, as circumventions,[37] is obviously alien to these studies. I share the observations of Bertrand du Marais and Claude Ménard concerning the Doing Business reports[38]:

> "We can therefore look at *Doing Business* reports as merely an assessment of the distance between a sample of cases that reflects an ideal model of Law, or rather the legal system that the authors are accustomed to, and the diversity of ways different countries with different legal systems are dealing with when confronted to these cases. As *Doing Business* rightly points out, this variety may to a certain extent stem from phenomena opposed to sound economic growth, e.g., heritage from legal tradition, rent seeking behaviours, and so forth. However, we cannot ignore that this variety also reflects ways to efficiently address social and economic specificities of different countries. In that respect, having competing systems, may be better than wanting full homogeneity."

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35 See footnotes 29 and 30.

36 Especially R. La Porta/F. Lopez-de-Silanes/A. Shleifer, 2006, *What Works in Securities Law?*, Journal of Finance 61 (2006), 1-31; but see M. Roe, *Legal Origins, Politics, and Modern Stock Markets,* Harvard Law Review 120 (2006) 460-527 for a subtle analysis of the relation of "market" and "legal" factors in – what he calls – an "iterative process" .

37 This important dynamic feature of regulation is detailed in E. Schanze, *Hare and Hedgehog Revisited: The Regulation of Markets That Have Escaped Regulated Markets*, Journal of Institutional and Theoretical Economics 151 (1995) 162-176.

38 C. Ménard/B. du Marais, *Can we Rank Legal Systems According to Their Economic Efficiency?* in: P. Nobel/M. Gets (eds.), *New Frontiers of Law and Economics* (Zürich, 2006), 25, italics in the original text.

V. Industry studies

Ronald Coase has criticised the dominant quantitative neo-classical approach in economics by recommending to his fellow economists to engage in the study of the real world "practices" of transacting.[39] This will typically lead to industry studies which might not allow the "measurement" of the direct impact of economic law but rather lead to meaningful comparisons and documented institutional experiences. These can be studied, followed, improved, or abandoned in future regulation or contracting.[40]

This exercise may be illustrated by two Marburg doctoral dissertations on the automobile industry in the two most significant threshold countries, Brazil and China.[41] They are based on extensive field studies, and advanced law and economics theory. These two studies illuminate the impact of economic law on state and society in the development context, and allow instructive comparisons.

Obviously, the development of a national automobile industry is a reasonable candidate for elaborating on general features of technology transfer transactions. Brazil and China, key population rich states on their respective continents, have a most varied cultural, societal and economic background. They also have gone different development paths which could hardly be aligned in a meaningful index scheme beyond the standard development measures. While Brazil has been part of the Western style democracies with property rights, standard features of law making and administration, China has kept up some of the basic tenets of its specific communist system with a gradual opening towards Western institutions, recently signalled by joining the WTO process and a reception of Western economic laws.

Hence, the studies had to address different aspects for explaining the workability of technology transfer transactions in each case. Whereas *Baigou Jiang* emphasizes the changing modalities of joint venture contracts since the arrival of the first automobile investments in China in the 70s, *Luiz Salgado* concentrates on the "innovative" structure of Brazilian modular production arrangements. *Jiang* shows that the "contracting" on various state levels and with various bureaucracies has worked as substitute for lacking property rights, the absence of a workable company law, and a deficient system of securities. *Salgado* demonstrates that the regional demand for simple and cheap cars and trucks may be facilitated by auctioning off specific inputs for a specified period in a collaborative production scheme adapted to sustainable development.

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39 R. H. Coase, *The Institutional Structure of Production*, American Economic Review 82 (1992), 713-719; classical applications are e g G. P. Miller, *The True Story of Carolene Products*, The Supreme Court Law Review (1987), 397-428, S. N .Wiggins and G. D. Libecap, *Oil Field Utilization: Contractual Failure in the Presence of Imperfect Information,* American Economic Review 75 (1985) 368-385; K. W. Dam, *The Economic Underpinnings of Patent Law,* Journal of Legal Studies 13 (1994) 247-271.

40 On the „technology" of drafting new arrangements from "old" design and modules see E. Schanze, *Legalism, Economism, and Professional Attitudes Toward Institutional Design*, Journal of Institutional and Theoretical Economics 149 (1993), 122-140; id. *International Standards: Functions and Links to Law*, in: C. Bruetsch/D. Lehmkuhl (ed.), *Law and Legalization in Transnational Relations* (Oxford, 2007) 166-184.

41 B. Jiang, *Symbiotische Rechtsstrukturen in der chinesischen Automobilindustrie* (Berlin, 2008); L. G. Salgado, *Die Modulproduktion in der Automobilindustrie Brasiliens* (Berlin, 2008).

In both cases, the authors observe features of "symbiotic relationships" which serve different strategic ends and economic policies.[42] The question of "institutional success" (or "impact on state and society") is obviously hard to divorce from both the technological and the economic development. Measurable advances are, no doubt, present in both cases, however in a totally different "context" of state and society.

D. Conclusion

The assessment of the impact of economic law cannot be isolated from the real choices and practices of the actors engaged in institutional design in a specific context. The old interventionist perspective, which is related to the new economic ranking literature, does not catch the interdependence of state and economy.

Institutional design relevant for economic transactions is best understood in terms of an incremental learning process. In reality, it does not only have *structure* but also a *biography*.[43] The requisite professional analysis can benefit from a cooperation of lawyers and economists who both should contribute their specific "technical" knowledge of "impactedness" for understanding the function of institutions in their economic context.

Hitherto, the law and economics movement has paved the track towards a mutual understanding of the relevant disciplines and towards common professional working routines in institutional design including the drafting of regulation.[44] The jurisdiction ranking movement may be impressive from a "technical" viewpoint of economic theory, but it faces a number of problems in its perception of the reality of regulation. These problems may be prompted by starting from the wrong end of the marathon of institutional analysis.

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[42] Explanation of the concept and summary of the relevant literature, see: E. Schanze, *Symbiotic Arrangements*, The New Palgrave for Economics and the Law 3 (1998), 554-559.

[43] E. Schanze, *Legalism, Economism, and Professional Attitudes Toward Institutional Design*, Journal of Institutional and Theoretical Economics 149 (1993), at 135 et seq.

[44] See R. A. Posner, *What is Law and Economics Today? An American View*, in: P. Nobel/M. Gets (ed.), *New Frontiers of Law and Economics* (Zürich, 2006), 89-97; E. Mackaay, *History of Law and Economics*, in: B. Bouckaert and G de Geest (eds.), *Encyclopedia of Law and Economics* (Cheltenham, 2000), 65-70; P. Behrens, *Economic Law Between Harmonization and Competition: The Law & Economics Approach*, this volume, supra p. 45-60; M. Roe, above note 36; E. Schanze, *What is Law and Economics Today? A European View*, in: P. Nobel/M. Gets (ed.), *New Frontiers of Law and Economics* (Zürich, 2006), 99-113.

The Fallacy of Cultivating the Home Turf: A Business Perspective

Dietmar Meyersiek[*]

Creating an internal market and strengthening competition was part of the objectives defined in the original proposal for a European constitution. Its successor document, the Lisbon Treaty, makes do without the reference to competition. An ominous decision, as it bears out the growing tendency of European governments to interfere with the delicate self-reinforcing and balancing feedback loops that ensure prosperity through a thriving economy.

The rule of law is a constituent element of advanced societies, and so are markets, competition, and trade. *Economic law* enables markets to function effectively by protecting property rights and contracts. *Markets and competition* are excellent mechanisms for organizing economic activity between individuals, because they offer choices and capitalize on the well-known propensity of people and businesses to respond to incentives. "Nations, too, benefit from competition,"[1] because competition performs three positive functions: 1) as an *incentive* instrument, 2) as an instrument to limit the use of *power*, and 3) as a *discovery* instrument.

Finally, fair trade and a level playing field are indispensable if the benefits from the rule of law, markets and competition are to accrue to all participants. Interference in individual markets (e. g. through price controls) leads to suboptimal economic results, i. e. loss of overall welfare. Protectionist moves and market distortions by governments/agencies prevent companies from improving productivity and offering superior customer value. Trade restrictions reduce the benefits from a country's comparative advantages and slow down growth.

This paper will (A) cite empirical evidence that the quality of a country's legal system correlates positively with economic performance, (B) argue that businesses and nations can flourish in the long term only if they readily embrace the challenges of competition, and (C) summarize essential conditions for achieving mutual, as opposed to one-sided, benefits from free markets.

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[1] V. Vanberg, *Auch Staaten tut Wettbewerb gut: Eine Replik auf Paul Kirchhof*, Discussion Papers on Constitutional Economics (Freiburg 05/2002).

A. The economic value of legal systems

The Canadian Fraser Institute publishes an annual "Index of Economic Freedom"[2] for 141 countries, based on a quantitative assessment of factors such as

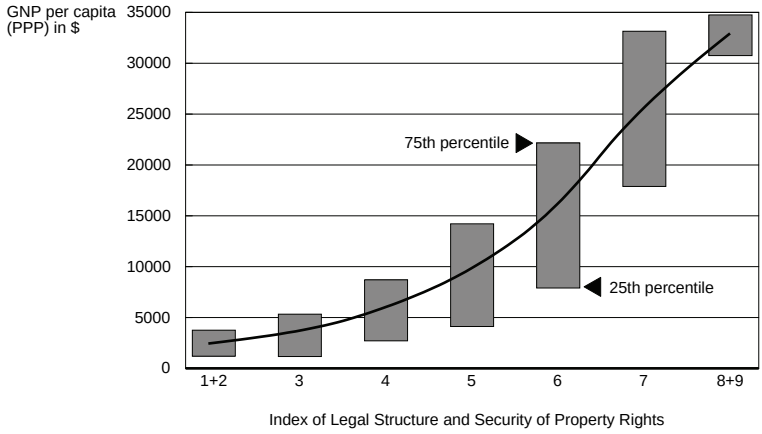
- Size of government
- Legal structure and security of property rights
- Access to sound money
- Freedom to trade internationally, and
- Regulation of credit, labour, and business.

In its assessment of a country's legal system, the Institute considers seven components:

1. Judicial independence
2. Impartial courts
3. Protection of property rights
4. Military interference in the rule of law and the political process
5. Integrity of the legal system
6. Legal enforceability of contracts
7. Regulatory restrictions.

The resulting rankings permit fascinating analytical insights. For instance, it turns out that the quality of a country's legal system is closely correlated (no causality implied) with its economic prosperity (purchasing-power-adjusted income per capita) – and this seems to be the case worldwide (Exhibit) …

Quality of the legal system and economic prosperity
– 141 countries –

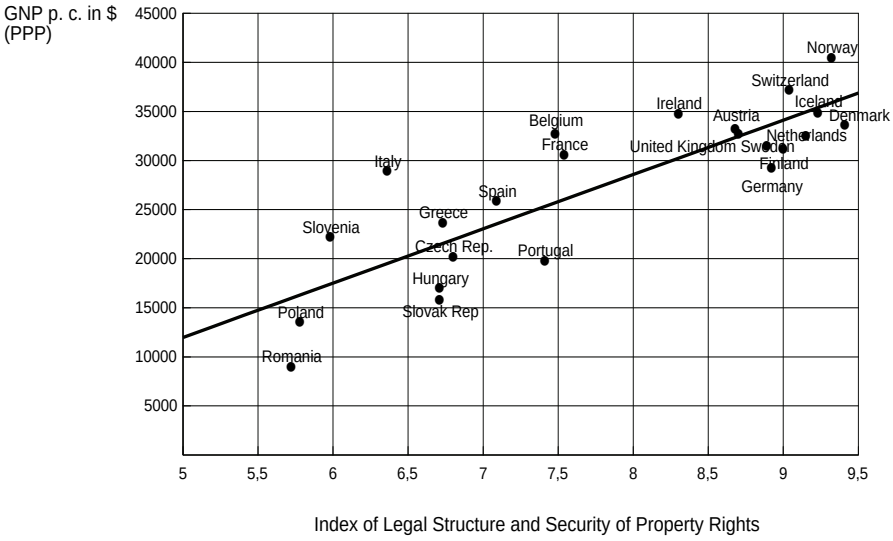


J. Gwartney, R. Lawson et al., Economic Freedom of the World, 2004 Annual Report, Economic Freedom Network, The Fraser Institute, Canada (data source), D. Meyersiek (analysis)

[2] J. Gwartney, R. Lawson et al., *Economic Freedom of the World, 2007 Annual Report* (Economic Freedom Network, The Fraser Institute, Canada).

… as well as for European countries (Exhibit).

Quality of the legal system and economic prosperity
– European countries –

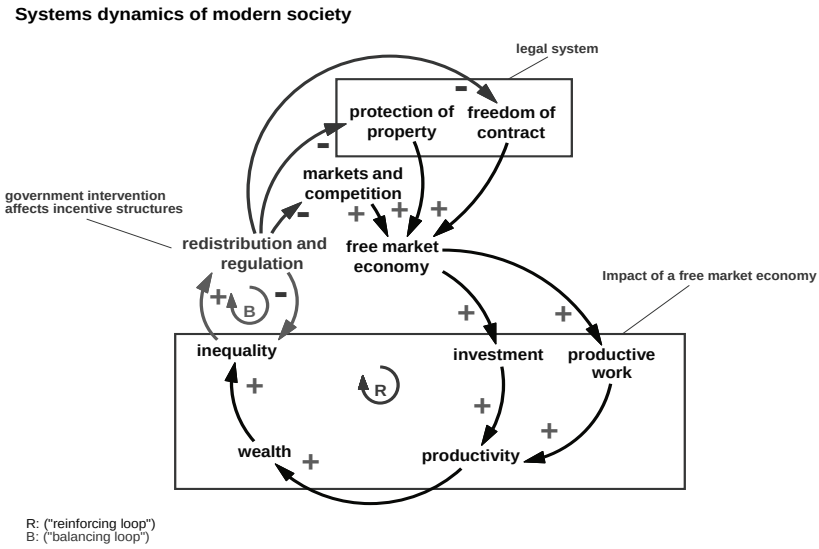


J. Gwartney, R. Lawson et al., Economic Freedom of the World, 2004 Annual Report, Economic Freedom Network, The Fraser Institute, Canada (data source), D. Meyersiek (chart)

B. Markets and competition as additional factors for successful economic dynamics

The rule of law ensuring protection of property and sanctity of contracts is only one of the factors contributing to economic performance. Free and undistorted markets provide incentives to work and to invest – and this typically leads to productivity and wealth.

The dynamics of modern society force us to find tradeoffs between freedom, wealth and equality. Along the path from a free market economy via investment and work to productivity and wealth, one side-effect invariably is inequality, which leads governments to interfere through redistribution and regulation – which actions in turn tend to have a negative effect on the incentive structure of an economy.



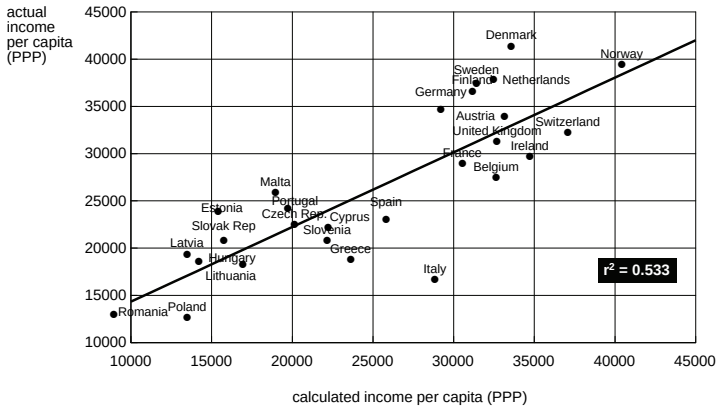
Regulation, economic protectionism or politically motivated interventions against market forces work like a flywheel on a steam engine: a powering-down of the engine by reducing steam inevitably results in unintended consequences, stagnation or standstill. In addition, government actions that reduce individual freedom, self-reliance and responsibility will produce the consequences which *John Stuart Mill* described in his essay *On Liberty*:

> A State which dwarfs its men, in order that they may be more docile instruments in its hands even for beneficial purposes, will find that with small men no great thing can really be accomplished; and that the perfection of machinery to which it has sacrificed everything, will in the end avail it nothing, for want of the vital power which, in order that the machine might work more smoothly, it has preferred to banish.[3]

Here again, the Fraser Institute's Index can be an eye-opener. If we expand our empirical analysis of the economic value of the legal system by adding the variable *scope of government activities*, we perceive a clear pattern: A high-quality legal system combined with a low level of government activity explain more than 50 % of the variance in the standard of living of European countries.

[3] J. S. Mill, *On Liberty* (Yale University Press, 2003) 175.

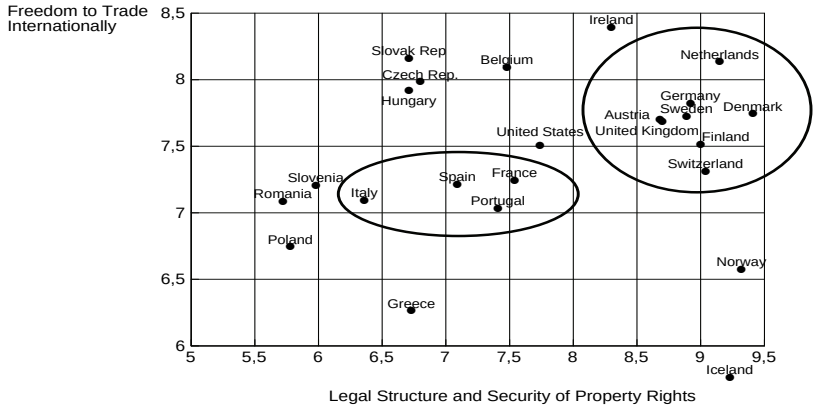
Income per capita (PPP) can be explained largely by the quality of a country's legal system and the size of government*



* Results of regression analysis: GNP per capita = -15842.4 + 6893.3 * index of legal system -1929.4 * index of size of government
J. Gwartney, R. Lawson et al., Economic Freedom of the World, 2004 Annual Report, Economic Freedom Network, The Fraser Institute, Canada (data source), D. Meyersiek (analysis)

Exploring yet another angle, consider a scatter diagram of the index for the legal system (on the X-axis) and the index for freedom to trade internationally (Y-axis) for European countries. It shows two particularly interesting segments (Exhibit).

Quality of the legal system and freedom to trade are correlated
– European countries and the United States –

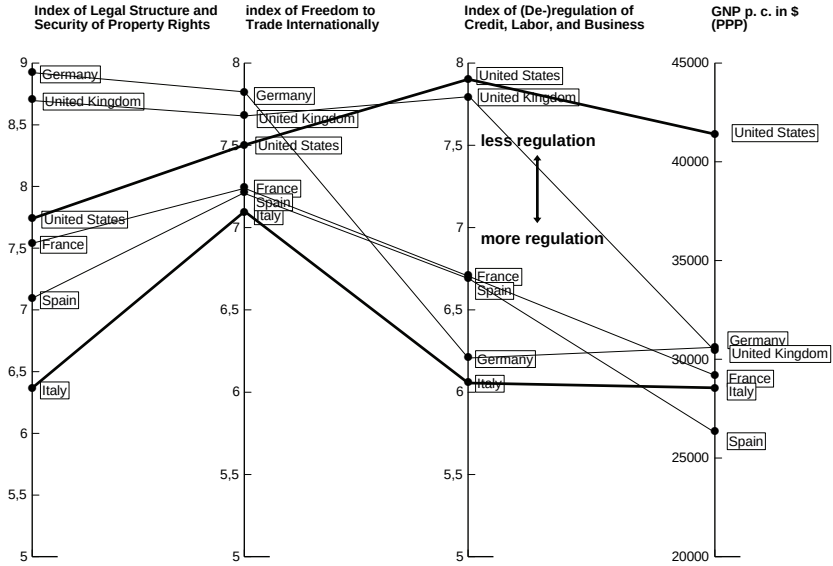


J. Gwartney, R. Lawson et al., Economic Freedom of the World, 2004 Annual Report, Economic Freedom Network, The Fraser Institute, Canada (data source), D. Meyersiek (chart)

Among the larger countries, one group including France, Spain, and Italy is marked by less freedom to trade and a less-developed legal system than another group consisting of, e. g., the UK, Germany, the Netherlands, Austria, and Switzerland. The former group seems to be more inclined to pursue mercantilistic policies, i. e. "cultivating the

home turf" – and, looking at their overall prosperity, they appear to be at a disadvantage. Of particular interest is the relationship between the index of deregulation (credit and labour markets and business) and a country's gross national product per capita – empirical support for the dynamic potential of less regulated economies.

Legal system, freedom to trade, deregulation and GNP p. c.
– Selected European countries and the United States –

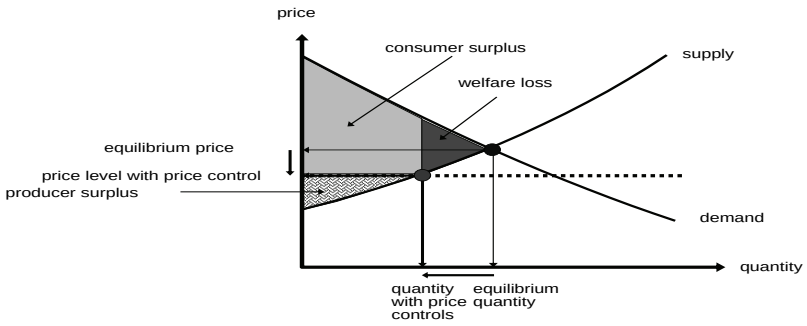


J. Gwartney, R. Lawson et al., Economic Freedom of the World, 2004 Annual Report, Economic Freedom Network, The Fraser Institute, Canada (index data), (-) Standort Deutschland, Ein internationaler Vergleich, Institut der deutschen Wirtschaft Köln (2007), 24 (GNP data 2005), D. Meyersiek (chart)

Clearly, at the national level, a high-quality legal system plus competition within a system of free trade and deregulation are good for prosperity. And such empirical evidence is borne out by well-known insights from micro- and macroeconomic theory.

It is the textbook mechanism of supply and demand: Lowering prices stimulates demand, and rising prices are an incentive to step up supply. Equilibrium is achieved at the intersection of the two curves (Exhibit).

Demand and supply



Establishing the equilibrium is best left to market forces, as has often been convincingly argued, e.g.:

> Markets are superior to governments for at least three fundamental reasons: a) they disseminate and process information more rapidly; b) they rely on more decision takers; and c) they provide, through the profit motive, an in-built incentive for agents to use this knowledge efficiently to promote ends valued by fellow citizens. Markets deliver economic results where nobody can be better off without simultaneously someone else being worse off.[4]

Or, as the former US secretary of the treasury and former president of Harvard University, Larry Summers, once said: "The invisible hand of the market is more powerful than the concealed hand of the government." Companies and industries will not survive, let alone become world-class national champions, if they are simply protected and sheltered from effective competition. In the words of Paul Geroski, former Chairman of the British Competition Commission: "It is competitive markets that produce such champions, not national governments."[5]

Trade and the wealth of nations. In an international setting, it may be appropriate to briefly recall the potential benefits of cross-border trade using *Ricardo's* theory of comparative advantage. What we have seen on the microeconomic level as a result of the collective intelligence of the market and the invisible hand, is equally valid for trade between countries.

With a given supply of labour (120 workdays each), Ireland could produce either 60 units of food or 120 units of clothing – or any linear combination thereof. England, with lower productivity in the production of clothing, has the choice between 60 units of food and 30 units of clothing – or linear combinations of these goods. For instance, without trade, Ireland might choose 30 units of food and 60 units of clothing, while England opts for 20 units of food and 20 units of clothing.

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4 M. Prowse, *The Independent* (May 8, 1995).

5 Quoted in: T. Duso, *Economic Patriotism and National Champions in the EU*, Humboldt Institution on Transatlantic Issues (February 2007) 11.

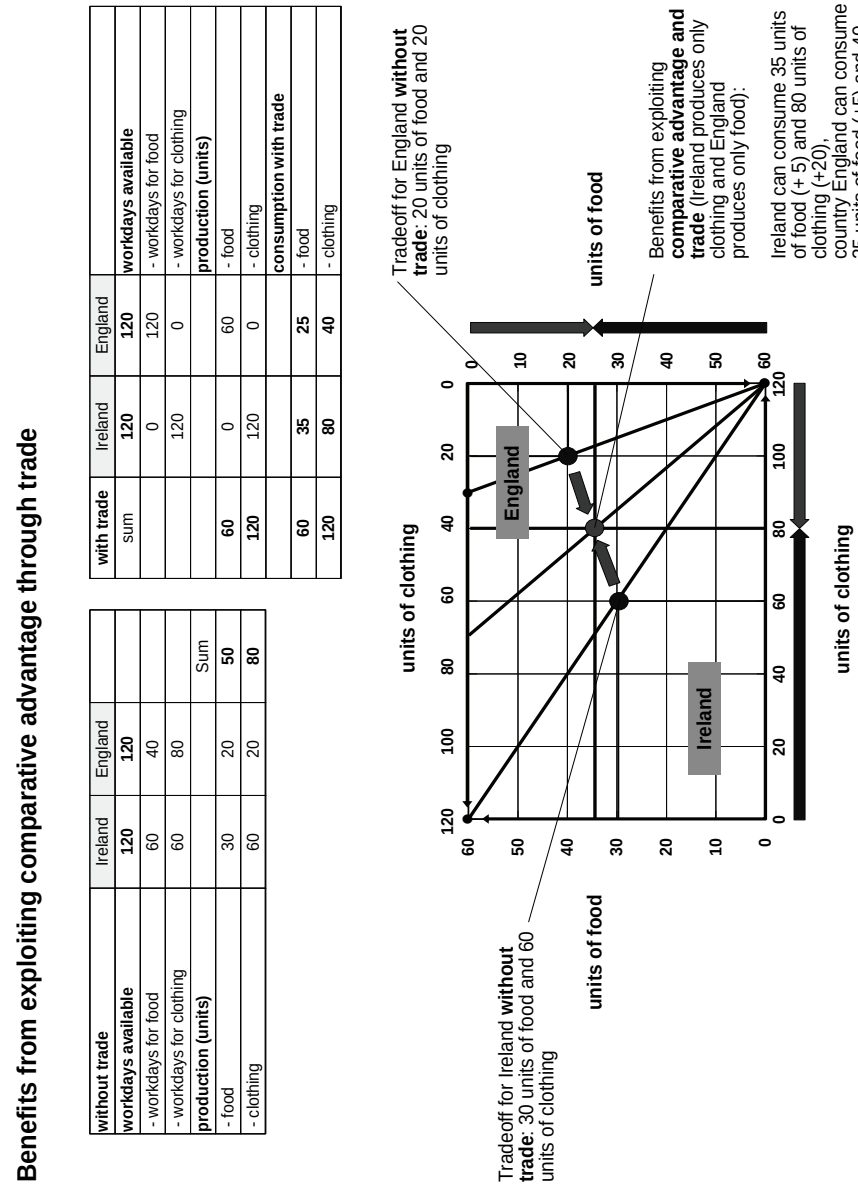
Benefits of free trade

– production and consumption without trade –

starting position	Ireland	England
workdays available	120	120
workdays per unit of food	2	2
workdays per unit of clothing	1	4

without trade	Ireland	England	
workdays available	**120**	**120**	
- workdays for food	60	40	
- workdays for clothing	60	80	
production (units)			Sum
- food	30	20	**50**
- clothing	60	20	**80**

The following chart shows that, with trade, if each of the two countries can be better off: specializing in what they do best (Ireland producing only clothing and country England producing only food), each can enjoy more of both goods – Ireland can consume 35 units of food (+ 5) and 80 units of clothing (+20), England can consume 25 units of food (+5) and 40 units of clothing (+20).



Differences in relative productivity (*Ricardo's* "comparative advantage") evidently are sources of mutual benefit through trade.

This was a brief overview of theoretical arguments and empirical evidence for markets as vehicles for optimal allocation of goods and for trade as an instrument for capturing economic benefits from specialization. In order to assess the – negative – impact of protecting domestic companies and nursing national champions, it is also necessary to understand the causes of individual companies' success or failure and to bear in mind the dynamics of industries.

Causes of lasting success of companies. Companies/businesses can only flourish if they are[6]

- *Better:* their products or services are superior to those of their competitors
- *Different:* they achieve uniqueness in their products or services
- *Faster:* their learning speed exceeds the speed of change in their environment, and
- *Genuinely profitable:* their profit exceeds their cost of capital.

1) A company's offering has to be better than that of its competitors. Companies can only survive in the long term if they offer an advantage relative to competition, e. g. in the form of a superior product or in terms of a better ratio of customer benefits to price. This insight is not new – *Charles Darwin* noted it in his work on the survival of the fittest in the struggle for life.

2) Companies can only offer an advantage relative to competition if they differentiate their products or services. This insight was also discovered in the 1930s by *Georgyi Frantsevitch Gause* in his work on competition in nature: „No two species can coexist who make their living in the same way".[7]

3) A company can only differentiate itself positively if its learning speed exceeds the speed of change in its competitive environment. This means that a company has to be more adaptive or faster, its rate of learning must be greater than the rate of change in its environment".[8]

4) To sustain such strengths, a company has to achieve a level of profitability that exceeds its cost of capital. Economic value is only created when a company earns an income above its cost of capital – a truism that is not always obvious to everyone in business. To avoid Chapter 11 or insolvency in the long term, earning a positive net income is not enough.

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6 On the basis of: W. F. Große-Oetringhaus, *Management-Lernen und Strategie – am Beispiel der Siemens AG*, in: H. Simon u. K. Schwuchow, *Management-Lernen und Strategie* (Schäffer-Poeschel, Stuttgart, 1994).

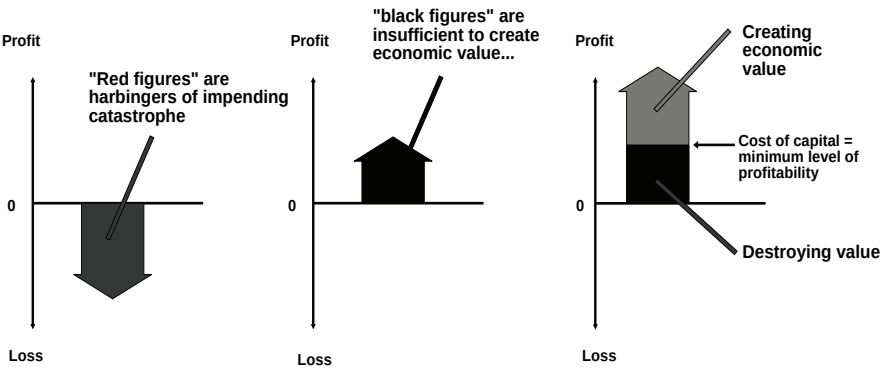
7 G. F. Gause, *The Struggle for Existence*, Chapter II "The Struggle for Existence in Natural Conditions" (Moscow, 1934), quoted in Große-Oetringhaus, ibid.

8 B. Garratt, *The Learning Organisation: And the Need for Directors Who Think* (Gower Publishing Company, Worcester 1987).

9 M. M. Porter, *How Competitive Forces Shape Strategy*, Harvard Business Review (Boston, March-April 1979).

10 D. Meyersiek, *Unternehmenswert und Branchendynamik*, Betriebswirtschaftliche Forschung und Praxis (Vol. 3/1991).

Only a level of profitability exceeding the cost of capital creates economic value...

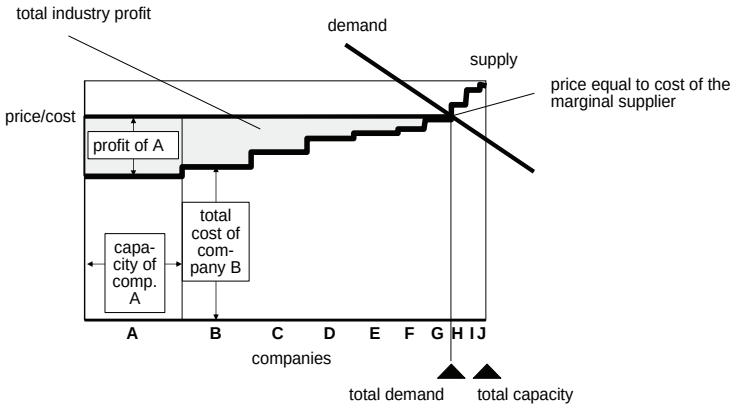


Better, different, faster, genuinely profitable: if these four conditions are met – and they require business acumen, entrepreneurial spirit, creativity and problem solving competence – then, and only then, does a company have a basis for sustainable growth and profitability.

Because the dynamics of competitive intensity (and therefore the economic outcome of competitive behaviour) are a function of supplier power, buyer power, barriers to entry and threat of substitute products/services,[9] companies – like countries embracing protectionism – may be tempted to reduce the level of competitive intensity. Invariably, this turns out to be short-sighted, counterproductive, and in most cases detrimental to consumers.

A visual display of structure and dynamics of an industry illustrates the forces at work (Exhibit).[10]

Industry cost curve
– illustrative –



D. Meyersiek, *"Unternehmenswert und Branchendynamik"*, Betriebswirtschaftliche Forschung und Praxis, Vol. 3/1991

As can be seen, profitability of an industry is, among other things, a function of the steepness of the supply curve, price elasticity of demand, demand relative to capacity, and the cost structure (e. g. variable vs. fixed costs).

Just as companies have to constantly adapt their products and services through productivity improvement and innovation in order to survive in a competitive environment, individual countries also have to respond to changing conditions if they want to prosper. And neither protectionism nor interventionism are suitable means towards that end, as *Ludwig von Mises* pointed out more than half a century ago:[11]

> Interventionism is not an economic system, that is, it is not a method which enables people to achieve their aims. It is merely a system of procedures which disturb and eventually destroy the market economy. It hampers production and impairs satisfaction of needs. It does not make people richer; it makes people poorer.
>
> Concededly, the interventionist measures may give certain individuals or certain groups of individuals advantages at the expense of others. Minorities may obtain privileges which enrich them at the expense of their fellow citizens. But the majority, or the whole nation, stands only to lose by interventionism.

Making borders less permeable by imposing tariffs, preventing foreign companies from entering domestic markets through various devices such as merger control/anti-takeover laws, politically engineered corporate mergers, "golden shares", "poison pills", populist appeals to "national security", "national interest" and corporate patriotism, are measures that bring, at most, temporary relief.

Such obstacles to cross-border mergers, and efforts at "cultivating the home turf" and/or increasing competitors' costs, are typical attempts to alter the rules of competition and to circumvent market mechanisms (recent examples: E.ON/Endesa, Russia/EADS, Suez/Gaz de France, OMV/MOL, Mittal/Arcelor, ACS/Autostrade, AT&T/Telecom Italia, Aeroflot/Alitalia, etc.).

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[11] L. von Mises, *Interventionism: An Economic Analysis* (1940), The Foundation for Economic Education, Inc., Irvington-on-Hudson (New York, 1998) 77.

Examples of market interventions

Acquirer	Target	Date	Type of market intervention	Result/impact
OMV (A)	MOL (H)	2007	The social-liberal Hungarian government calls the intention a "hostile takeover" and announces to prevent it by legal means.	Merger called off, potential synergies of 400 mill. Euro p. a. had been identified
Mittal (IND)	Arcelor (LUX)	2007	Merger considered by Luxemburg to be a "national catastrophe" - (social, financial, and industrial policy reasons).	Merger leads to formation of the world's largest steel company (with synergies of about 1 bill. Euro p. a.), Mittal pays 130 Mio. Euro to Russian Severstal for ist role as "White Knight".
AT&T (USA)	Olympia/ Telecom Italia (I)	2007	Italy threatens to trigger legislation that would protect Telecom Italia from falling to foreign control.	AT&T drops plans to buy a stake in Olympia (major shareholder in Telecom Italia)
Enel (I)	Suez (F)	2006/2007	French government passes a law allowing it to raise hurdles, impose conditions or veto foreign takeovers in 11 'sensitive' sectors.	France announces merger of Suez and Gaz de France (80% owned by French government). French government retains control with 35% share.
Abertis (E)	Autostrade (I)	2006/2007	Italy prevents takeover of Autostrade (Italy's infrastructure minister threatens to revoke Abertis' concession and Italy continued to increase hurdles by continually introducing new requirements) - "foreigners shouldn't own Italian roads".	Takeover attempt abandoned.
UniCredit (I)	HypoVereinsbank (D)	2005/2007	Polish government fought against a merger of the Polish HVB and UniCredit subsidiaries (BPH and Bank Pekao) in order to protect the dominant position of a state-owned bank.	Italy agrees to job guarantees until March 2008
Thales Group (F)	Atlas Elektronik (D)	2005/2006	German government is worried about losing know-know in an sensitive area (defense industry) to foreigners, uses a foreign trade law ("Außenkontrollgesetz", weapons control law) to block the acquisition.	ThyssenKrupp acquires 51%, EADS 49% of Atlas Elektronik.
E.ON (D)	Endesa (E)	2005/2007	A Spanish law passed in 1999 prevents acquisition of Spanish energy companies by foreign companies (law contended by EU). Spain pursues strategy of building "national champions", raises hurdles for E.ON with 13 restrictions/requirements to be met and brokers a blocking shareholder partnership between Acciona, a Spanish construction company, and the Italian utility Enel.	Acciona, S.A. and Enel Energy Europe, S.R.L. acquire 46,06% of Endesa. E.ON acquires Endesa's French and Italian interests.
Sanofi-Synthélabo (F)	Aventis (F)	2004	Intervention by then finance minister Sarkozy to prevent acquisition of (French) Aventis by (Swiss) Novartis, which may have resulted in Sanofi being acquired by a foreign company.	Merger of sanofi-aventis (world's 3rd largest pharmaceutical company)
Finmeccanica (I)/ Carlyle (USA)	Avio (I)	2003/2006	Italian government prefers 1.4 bill. offer over bid of 1.8 bill. Euro by Piaggio Aero/Doughty Hanson & Co. Ltd.	Italian government retains dominant position in Finmeccanica.
Siemens (D)	Alstom (F)	2002/2003	France wanted to preserve Alstom as an independent conglomerate, bought 20% of Alstom, threatened with nationalization of Alstom's turbine business.	Alstom stays independent.
BMW (D)	Rolls-Royce/ Bentley (UK)	1998	Public resistance	Significant investment by BMW for restructuring Rolls-Royce

As far as national interest is concerned, Tomaso Duso questions government motives and reasoning:[12]

> The question then arises: what such interest ought to be? Are, for instance, job losses due to a cross-border merger a threat to the national interest? And, if yes, why should a Government be more concerned about job losses from international trade or cross-border mergers than about job losses from increasing domestic competition, or changing technology which are very often seen as welfare increasing events? The essential question is, therefore, what is the real objective of industrial policy and what should this be? Our claim will be that the concept of "national interest" often has to do with

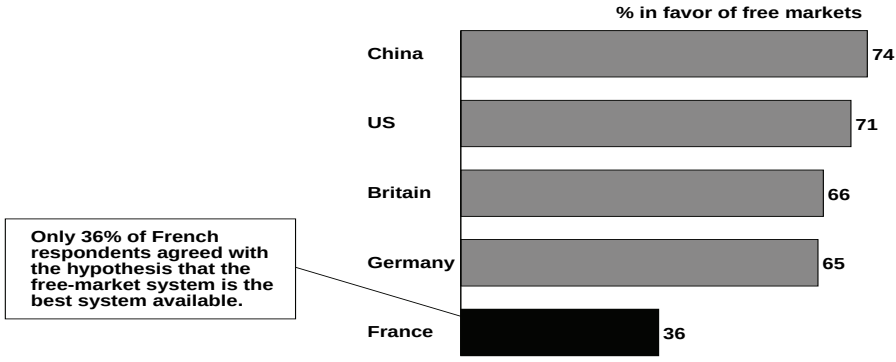
12 T. Duso, *Economic Patriotism and National Champions in the EU* (Humboldt Institution on Transatlantic Issues, February 2007) 4.

close political connections, political sensibility, and public perception rather than with pure economic reasons.

In almost all cases of protectionism/interventionism – invariably a function of a country's inability and unwillingness to adapt –, the result is that consumers are deprived of productivity improvements and businesses are constrained in developing to their full potential.

Even so, such warding-off of perceived threats from new entrants or increased competition is often anything but unpopular: According to a survey by the Program in International Policy Attitudes at the University of Maryland, only 36% of French respondents agreed that the free-market system is the best system available.

"There is a significant lack of economic culture in this country"
(French Finance Minister Thierry Breton, 2006)



(-) Program in International Policy Attitudes, University of Maryland, quoted in S.E.D.'s May 2006 Report, Chapter IV: Incroyable! A New Shift Back to the Left?

Apparently, they have learned to ignore the insight of their fellow countryman Frédéric Bastiat (1801-1850), who said:

> The state is the great fictitious entity by which everyone seeks to live at the expense of everyone else.[13]

C. Conditions for prosperity

The benefits from free markets in an international setting do not come about automatically, of course. They need to be earned by fulfilling a number of conditions, as cogently outlined in a recent report by Woody Brock, President of *Strategic Economic Decisions, Inc.*[14]

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13 F. Bastiat, *Selected Essays on Political Economy with an Introduction by F. A. von Hayek* (Foundation for Economic Education, Irvington-on-Hudson, New York, 1995), 144.

14 H. W. Brock, *Quarterly Report, Chapter II: "TODAY'S TRUE BLACK SWAN – The Conceit of Bogus Capitalism"*, Strategic Economic Decisions Inc., (September 2007).

Benefits from free domestic markets, as well as the attractiveness, prosperity and stability of nations, depend to a large extent on these preconditions:

1. *the rule of law* (including sanctity of contracts, non-bribable judges and protection of (intellectual) property),
2. *flexible markets* for labour, products, capital and currencies,
3. *a well-defined scope of legitimate government intervention* (e. g. providing public goods, preventing pollution and addressing the issue of distributional justice by some form of progressive taxation), and
4. *freedom to trade internationally* (including market-determined exchange rates as well as open and transparent capital accounts).

Conditions for prosperity*

1. Social and Political Preconditions	**rule of law must prevail**	sanctity of contracts	
		non-bribable judges	
		transparency in commercial relations	
		protection of intellectual property rights	
2. Market Preconditions	**(i) perfect competition**	**absence of bargaining power by cartels, labor unions, or oligopolies**	
		full deregulation of product, capital, and labor markets	
		acceptance of "prices as given by the invisible hand" with **no ability to impact, much less manipulate prices of anything**	
	(ii) risk aversion on the part of all consumers, or equivalently, diminishing marginal utility for goods		
	(iii) complete hedging markets	risk averse agents must be able to hedge every and any risk by creating appropriate portfolios of derivative securities	
	(iv) absence of non-market phenomena or "externalities"	e.g. pollution, etc. where the price system either fails to exist or else misallocates resources	
	(v) diminishing returns to scale in most (but not all) industries		
3. Economic Preconditions	(i) need to regulate business cycles and financial market crises	via appropriate fiscal and monetary policies	
	(ii) **need to redress market externalities** (e.g. pollution) and to provide basic public goods (e.g. a legal system, a military, etc.)		
	(iii) need to address the issue of distributional justice ('e.g., determining the optimal rate of progressivity of the tax code)	e.g., determining the optimal rate of progressivity of the tax code, including negative income taxes for the ill or the very poor	
4. Preconditions for International Trade	The economies of every nation that trades with other nations must possess an economy meeting the above "domestic desiderata"		
	all currencies must be market determined (except in times of crisis)		
	all capital accounts must be open and transparent		

*H. W. Brock, *Quarterly Report, Chapter II: "TODAY'S TRUE BLACK SWAN - The Conceit of Bogus Capitalism"*, Strategic Economic Decisions Inc. (September 2007)

Similarly, *William J. Baumol* summarized the "four elements of a well-oiled economic growth machine":[15]

1. First, and perhaps quite obviously, in the successful entrepreneurial economy, it must be relatively easy to form a business […] As a corollary, abandoning a failed business (that is, declaring bankruptcy) must also not be too difficult […] A well-functioning financial system must also exist […] And the importance of flexible labor markets cannot be overstated.
2. Second, the rule of law – property and contract rights in particular – is especially important." […]
3. Third, government institutions must discourage activity that aims to divide up the economic pie rather than increase its size. […]
4. Finally, in the successful entrepreneurial economy, government institutions must ensure that the winning entrepreneur […] continue to have incentives to innovate and grow. […] The ostensible importance of effective antitrust laws here comes to mind, but we place greater emphasis on openness to trade (which works automatically and without the long lead times inherent in legal antitrust enforcement).

For everyone to be better off, it is essential that legislators, agencies and politicians acknowledge the superiority of markets and competition and that they confine themselves to redressing externalities and preventing dysfunctional incentive structures. Theoretically as well and empirically, there is little evidence in favour of governments meddling with market mechanisms; interventionism of the trembling hand has few, if any, merits.

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[15] W. J. Baumol, R. E. Litan, C. J. Schramm, *Good Capitalism, Bad Capitalism* (Yale University Press, New Haven and London, 2007) 7 f.

Economic Law as an Economic Good: Reflections of a European Judge

David Edward[*]

Our topic, "Economic Law as an Economic Good", raises interesting questions of philosophy and semantics.

What is "economic law"? Is this a general description of the rules of law (notably the rules of competition law) that are brought to bear on economic activity? Or is it, more particularly, a form of law that is related to and dependent upon the "laws of economics"? If the latter, the concept will be very different depending on whether we believe in free-market economics or Marxist economics.

In what sense might economic law be an "economic good"? Is the word "good" used as an adjective or as a noun? Is economic law "good" [adjective] in the sense that bringing the law to bear on economic activities is generally speaking, but not always, productive of economic benefit? Or is it "a good" [noun] in the sense that economic law is an economic asset (*Vermögen*) that can be deployed and exploited to produce economic advantages, and whose value will increase to the extent that the law is developed and applied?

In the hope of providing an answer to some of these questions, I will first discuss the notion of "interjurisdictional competition" that was put forward by some of the economists who took part in our conference.

A. Interjurisdictional competition

In its most radical form, the thesis, as I understand it, is that rule-makers, particularly economic regulators, should be treated as suppliers of a "product" – the product in question being the rules they make, apply or enforce. They are in competition with other rule-makers in their own country and in other countries, and are subject to the same laws of economics as the suppliers of other products. Where there is interjurisdictional competition, economic operators can influence the rule-makers by migrating to the environment where the rules are most favourable to economic activity. Where there is no competition, this exit strategy is not open. So, interjurisdictional competition is "good" because it makes rule-makers more efficient, more effective and more responsive to the market.

Another way of expressing the underlying idea seems to be this. Economic rule-making is necessarily linked to the laws of economics. The same economic laws apply to rule-makers as apply to those who conduct economic activity on the basis of those rules. Competition is an economic good. Therefore, competition between rule-makers is an economic good. To the

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[*] Professor Emeritus of the University of Edinburgh; Judge of the European Court of Justice 1992-2004.

extent that rule-makers are not in competition, economically undesirable results will follow. A consequence of this analysis, if I have understood it correctly, is that we should welcome a situation in which economic regulators in different countries adopt divergent approaches. The market will show which approach is more efficient from an economic point of view. Pressure for uniformity of approach, notably in the European Union, is economically damaging.

Thus, *Vaubel* argues that

> The European Community/Union suppresses interjurisdictional competition by approximating and centralizing legislation especially in the fields of taxation and regulation. (By regulation, economists mean interference with the freedom of contract) … Since the European institutions have considerable competencies but little money, they focus on regulation – especially of labour, financial and product markets. Regulation does not cost them anything – its cost has to be borne by those who have to comply with it. Interference with the freedom of contract may be justified where the contract is concluded at the expense of third parties (e.g., among the participants of a cartel or possibly a merger) but it is highly problematic in most other cases and usually inferior to tax/subsidy schemes or liability rules which internalize the "external effects" without restricting individual choice … The Commission has a vested interest in centralization because this increases its power … Like the Commission, the members of the European Parliament have a vested interest in centralization at the Union level because such centralization increases their power … The justices of the European Court of Justice have a vested interest in transferring power from the member states to the European level because, by doing so, they can increase their own influence. The larger the powers of the European institutions, the more numerous, important and interesting are the cases which the European Court may decide.

This Orwellian characterisation of the activities and motives of European commissioners, parliamentarians and judges does not correspond to my personal experience. But it would be naïve on my part to claim that those who hold office in the institutions of the European Union are immune from ambition or the temptations of power. They are not unique in this respect and no-one observing the tensions between central government and regional or "devolved" governments in Britain, Spain and other countries could pretend that the institutions of Brussels and Luxembourg are uniquely prone to a desire to regulate and control.

That said, it is not necessary to justify or defend the attitudes and actions of the European institutions or their members in order to take issue with the broader proposition that "interjurisdictional competition" is, *by virtue of the laws of economics*, an economic good.

The activities of making, applying and enforcing rules are activities conducted by human beings. Laws, rules and regulatory regimes do not make or administer themselves. Opinions and attitudes change over time as to what is right, appropriate or just. Lawmakers and law-enforcers are quite as susceptible to public opinion and quite as prone to error, temptation and ambition as other human beings.

So we can accept that some rule-makers, including judges, may be motivated by a competitive desire to advance their careers, to seek the applause of the press and public,

or to shine more brightly than their colleagues in the intellectual firmament. This will sometimes affect the decisions they take in making rules or applying them.

It is also true that national systems of taxation and regulation are (at least in a sense) in competition with each other, and that economic operators tend to migrate towards the system that imposes the lowest burden of taxation and the lightest regulatory regime. There are examples in abundance to show that that is so.

There are, however, other considerations that influence those who have to decide what should be the tax or regulatory regime, what should be the level of taxation, or what should be the intensity of regulatory control. Legislative choices are made for a variety of reasons – not least the preferences of the electors expressed through the ballot box. That, after all, is what democracy is supposed to be about. The electors of some western European countries, notably some of the Nordic countries, are prepared to accept a higher tax burden in exchange for enhanced social provision, both for themselves and for others.

The investment choices of economic actors *condition* the willingness of elected governments to comply with popular demand for higher public expenditure or more intensive regulation. But they do not *determine* the decisions they take. There is no economic "law" that *requires* governments to give priority to the preferences of economic actors or penalises them if they do not do so.

As regards taxation, recent events in the UK illustrate the point. Public opinion has become hostile to the favourable tax treatment of so-called "non-doms" (those who are economically active in the UK, and in some cases live there for much of the year, but are not domiciled there for tax purposes). Public opinion caused the government to propose a levy on non-doms. This led in turn to a threat on the part of the non-doms that they would leave the country, taking their economic (and in some cases philanthropic) activity with them. The threat caused the government to modify its proposal, but not to abandon it.

It remains to be seen whether, and to what extent, the levy on non-doms will in fact cause them to migrate to countries with a more favourable tax climate. Those who will be adversely affected by higher taxation can be expected to lobby against it and to utter dire warnings in the hope of influencing the decision. This may or may not cause the government to alter its policy. What matters for present purposes is that the decisions of the rule-makers are not determined exclusively by their economic effect.

Nor, since threats are frequently not carried out, does increased taxation necessarily affect the behaviour of tax-payers. The decision to move to a more tax-friendly environment will depend on many factors, including the enchantments or otherwise of life in Monte Carlo or the Cayman Islands.

Similarly, as regards the effect of regulation, both the United Kingdom and, to a lesser extent, the United States have traditionally applied "regulation with a light touch" to the financial sector. This promotes economic activity, and might be thought to illustrate the merits of interjurisdictional competition in the sense of attracting financial operators to New York or London. However, recent disturbances in financial markets have led both the UK and US governments to propose tighter regulation of the financial sector and closer co-operation in doing so, implying a diminution in interjurisdictional competition. In the United States, the reforms proposed by the Treasury Secretary would involve a shift in power from the states to the federal administration, again implying a diminution in interjurisdictional competition.

It remains to be seen whether, in the long term, concerns about the adverse consequences of regulation with a light touch will lead to a more intensive regulatory regime and a diminution of interjurisdictional competition. What cannot be contended is that experience has demonstrated the economic merits of unrestricted interjurisdictional competition.[1]

I have a further difficulty in understanding the more extreme arguments in favour of "interjurisdictional competition". Who is said to be in competition with whom and about what? In particular, what, for this purpose, is a "jurisdiction"? Use of the expression "interjurisdictional competition" is confusing because it is insufficiently precise.

The word "jurisdiction" is used in English in several different senses. Following the original Latin term *jurisdictio*, it may be used (i) in an abstract sense, to connote the authority or power to administer justice, or more broadly the power to *apply and enforce* (but not to *make*) rules of law, or (ii) in a more concrete sense, to refer to the territory within which "jurisdiction" (in the abstract sense) may be exercised. The word is now also used in English (iii) to refer to the court or other authority that exercises jurisdiction, and thence more widely (iv) to refer to the authority that has power to *make* rules and well as the power to apply and enforce them.

In the narrow sense, "jurisdiction" corresponds to (but does not necessarily have the same meaning as) *compétence* in French and *Kompetenz* or *Zuständigkeit* in German. Using the word in this sense, lawyers are concerned with identifying the court or authority that "has jurisdiction". Which court or authority is entitled to judge the dispute or matter at issue?

The legal rules regulating "jurisdiction" in this narrow sense do not seek to identify which rules of law are to be applied by the court having jurisdiction. A French court may have jurisdiction to try a case but be required, by agreement of the parties or by the rules of private international law, to apply the law of Germany or Estonia. That is a question to be determined (in English terminology) by the rules of "conflict of laws" rather than "conflict of jurisdiction".

Using the word in this narrow technical sense, it has been said that an essential purpose of public international law is "to confer, distribute and regulate jurisdiction".[2] In the field of private international law, the purpose of the "Brussels I" Convention on *Jurisdiction* and Recognition and Enforcement of Judgments (now embodied in Regulation 44/2001/EC) is "to unify the rules of conflict of *jurisdiction* in civil and commercial matters and to simplify the formalities with a view to rapid and simple recognition and enforcement of judgments".

For most lawyers, interjurisdictional conflict (in the narrow sense) is something to be avoided. "Forum shopping", which leads to concurrent litigation in more than one country, imposes non-productive costs on the parties (including economic actors) concerned. It is liable, in the end, to lead to inconsistent judicial decisions with all of which the parties cannot comply. "Brussels I" seeks to avoid such situations as does the subsequent "Brussels II" Regulation (1347/2000/EC) on matrimonial and child custody disputes. In its original form the latter Regulation was described as "possibly the most anti-family and unconciliatory piece of legislation in family law".[3] This was because the Regulation

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1 The Text of this article was submitted in August 2008.

2 Rousseau, *Principes de Droit International Public*, 93 Hague Recueil (1958, I) p. 394 ; Mann, *The Doctrine of Jurisdiction in International Law*, 111 Hague Recueil (1964, I) p. 15 and 36.

3 See www.familylawweek.co.uk/library.asp?i=803.

discouraged the processes of mediation, reconciliation and early settlement (as opposed, that is, to the exercise of jurisdictional competence). There is no economic benefit (other than to the lawyers) from interjurisdictional disputes about matrimonial property or the custody of children.

Hence, also, the sustained objections over many years to the "effects doctrine", which was invoked by the US courts to justify assuming penal jurisdiction over alleged violations by foreign corporations of US antitrust law. That particular dispute is now muted because the EU and others have themselves adopted a form of effects doctrine in order to assert jurisdiction over third country nationals (including corporations). But if all states were to adopt an unrestricted version of the effects doctrine, conflicts of jurisdiction would be unavoidable. Karl Meessen has written extensively on the legal techniques by which such conflicts can be avoided.[4]

The reason why public international law and private international law seek to avoid conflicts of jurisdiction (in the technical narrow sense) is not for the economic benefit of lawyers. The purpose (over centuries of effort) is to promote legal certainty in the hope of promoting order in international relations in the public and the private sphere. It is of no advantage to economic actors, any more than anyone else, to be subjected to mutually incompatible regulatory requirements or to be subject to double jeopardy in respect of one and the same course of conduct. This consideration is all the more important in a "globalised" world where economic actors trade in many jurisdictions (in the territorial sense) and are therefore, potentially, subject to the regulators of each of them, applying not only their own rules but also their own economic theories.

It is idle to say that economic operators can "migrate" to the most favourable jurisdiction. Multinational corporations trade across jurisdictional boundaries and are liable to be caught by the effects doctrine whether or not they set up an establishment within any particular jurisdictional territory. Even quite small enterprises operating in frontier zones, such as Luxembourg, are subject to regulatory capture by more than one regulator.

It may be thought to be acceptable (within limits) that US antitrust and EU competition regulators should adopt a different attitude to the conduct of global operators such as Microsoft, and that they should issue orders or impose fines according to different legal and economic criteria. The result will be less obviously acceptable if regulators in other jurisdictions throughout the world also decide to issue orders and impose fines according to whatever criteria they may choose to adopt. Specifically, it is difficult to see what "economic good" will be achieved thereby.

Is this point of view wrong? Are lawyers mistaken in believing that the risk of exposure to incompatible regulatory requirements – let alone the actuality – is something that is to be avoided for legal and for economic reasons? If not, what is the proper scope of interjurisdictional competition that is said to produce desirable economic results?

This problem is fully discussed in *Wolfgang Kerber's* paper *The Theory of Regulatory Competition and Competition Law*. It is sufficient for me here to quote one short passage:

> General conclusions about the question whether regulatory competition is mostly beneficial or harmful are not possible. It depends crucially on the kind of regulation and the field of the law, on a number of specific circumstances and on a set of rules

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4 Meesen, *Conflict of Jurisdiction under the New Restatement,* 50 Law and Contemporary Problems 47 (1987); idem, *Economic Law in Globalizing Markets* (The Hague, 2004) p. 28 et seq., 95 et seq.

> governing regulatory competition, whether or not regulatory competition can be recommended or should be avoided …

The extent to which regulatory competition is workable will depend on the extent, location, social attitudes and other conditions of the "jurisdictions" in question (in the territorial sense). In some respects it will be easier for regulatory authorities to make and apply their own rules according to their own economic theory or perspective if their writ runs over a relatively large territorial area (Germany or France) or in a peripheral region with a strong sense of community obligation (Scandinavia). Most notably, it was possible to apply Marxist theory (however disastrously) in the former Soviet empire. On the other hand, experimentation with low-tax regimes seems to have been easier in relatively small states (Estonia and Ireland).

Again, the viability of interjurisdictional competition may depend on the relative strength and independence of the "jurisdiction" (*autorité; Behörde*) that makes or applies the rules. For example, the German Cartel authorities were, for a long time, able to pursue a more active regulatory policy than their counterparts in the United Kingdom where competition policy (so far as it existed) was subject to political control and interference.

There are, in effect, many variables to be taken into account. It is surely simplistic to argue that *all* rule-makers and rule-appliers are suppliers of a product (regulation); that they are *always* in competition with each other, still less that they are in *economic* competition with each other; or that the legal system, as a basis for economic activity, will work better if they are. That approach seems to me to obscure rather than assist analysis. The activities and decisions of rule-makers and rule-enforcers undoubtedly have economic consequences, but it does not follow that they are economic actors in the same sense as those engaged in industry and commerce. That is not to say that rule-makers are more virtuous than industrialists or businessmen. It is simply a plea not to say that apples are the same as oranges because they are both edible fruits.

An analysis that focuses on the merits of interjurisdictional competition to the exclusion of other political, social and (I would suggest) economic imperatives facing the rule-maker is inadequate to explain why, and in what sense, economic law is an economic good. That is not to say that human motives are irrelevant – quite the contrary – provided that one accepts that the motives in question need not necessarily be motives of self-interest. There may be may be rational or intellectual motives for adopting one course of action rather than another.

Thus, one might accept that there was a period when the European Commission, and perhaps also the European Court, attached excessive importance to harmonisation as a mechanism to promote the internal market. Differences in national legislation and regulation were perhaps too readily seen as "barriers to entry" – not least because economic operators claimed that they were.[5] On the other hand, no-one who has spent more than ten years as a judge of the European Court, as I have done, can be blind to the multifarious ways in which member states have used taxation and other forms of economic

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[5] See the long saga of litigation before the European Court, culminating in the judgment in Joined Cases C-267/91 and C-268/91 *Keck & Mithouard* [1993] ECR I-6097. Whatever criticisms may be levelled against this judgment (and there have been many), it cannot possibly be characterised as an example of the "vested interest of the judges of the European Court in transferring power from the member states to the European level because, by doing so, they can increase their own influence".

regulation as a weapon of protectionism. How are we to draw the line of demarcation between the merits of interjurisdictional competition and the evils of interjurisdictional protectionism? Economic theory on its own offers no answer to this question.

It seems to me that the argument in favour of interjurisdictional competition is essentially an economist's argument against harmonisation for its own sake and in favour of "subsidiarity" – in favour of allowing national, regional and even local authorities to make their own rules and take their own decisions, unless there is an overriding interest in harmonisation or uniformity? If so, the economic argument is simply the expression in other terms of the political argument that has been going on in Europe since before the Maastricht Treaty in 1992.

B. An alternative analysis

I take as a starting point what was said at the conference by *Hans Jürgen Gruss*, Chief Counsel at the World Bank: "The effectiveness and efficiency of legal institutions is a *sine qua non* of economic development".

Law and legal institutions provide the infrastructure of economic activity, in the sense that they form the background against which – or the context within which – economic activity is carried on. Effective and efficient economic activity requires effective and efficient legal institutions. Another way of putting the same point is that economic activity produces the best results if it is conducted in the context of the Rule of Law. This implies that the citizen – including the citizen as an economic operator – will be governed by known laws impartially administered.

On this view, the actions and decisions of rule-makers and regulators are not of the same logical character as the actions and decisions of economic actors. Rather, they provide the background against which – or the context in which – economic actors have to take their decisions. In this respect, "economic law" is no different from other forms of law.

This leads me to suggest a more nuanced – and, I would suggest, more realistic – approach to the question whether, and in what sense, economic law may be an economic good. For this purpose, I assume that "economic law" consists of the body of law (notably but not exclusively competition law) that is intended to condition the behaviour of economic actors. The economic actors in question include governments since the law on state aids and public procurement (which is an aspect of competition law) are directed at conduct on the part of government or government agencies that distorts competition.

It is perhaps worth noting that economic law in this sense is designed as much to condition behaviour as to prescribe results or impose penalties. This is characteristic of other aspects of law – for example, laws against gender or race discrimination – that have developed in western democracies in the latter part of the twentieth century. Ideally, the law will not need to be applied because people will refrain from behaving in a way that would attract its attention.

The concept of law as a means of conditioning human behaviour echoes the approach of Madison to the US Constitution. Madison's approach reflected the thought of those who taught him, two of whom were Scottish Calvinist ministers (pastors) - notably John Witherspoon, President of Princeton, who was one of the signatories of the Declaration

of Independence. Their premise was that man is essentially sinful but capable of good actions or, as Madison put it,

> As there is a degree of depravity in mankind which requires a certain degree of circumspection and distrust; so there are other qualities in human nature, which justify a certain portion of esteem and confidence.

This led to his designing a constitution based on "checks and balances" between political institutions and political actors. [6]

A similar line of thought was pursued a hundred years later by a Scottish lawyer and politician, James Bryce, whose writings played a major part in the design of the Australian constitution (amongst others). It proceeds, to some extent, upon the same premises as to human behaviour as the interjurisdictional competition thesis discussed above, but reaches a different type of conclusion:

> Of the many analogies that have been remarked between Law in the Physical and Law in the Moral World, none is more familiar than that derived from the Newtonian astronomy, which shows us two forces always operative in our solar system. One force draws the planets towards the sun as the centre of the system, the other disposes them to fly off from it into space. So in politics, we may call the tendency which draws men or groups of men together into one organized community and keeps them there a Centripetal force, and that which makes men, or groups, break away and disperse, a Centrifugal. A political Constitution or frame of government, as the complex totality of laws embodying the principles and rules whereby the community is organized, governed and held together, is exposed to the action of both these forces … [T]he history of every community and every constitution may be regarded as a struggle between the action of these two forces, that which draws together and that which pushes apart, that which unites and that which dissevers … [L]egal institutions and formulae do not belong to a sphere of abstract theory but to a concrete world of fact. Their soundness is not merely a logical but also a practical soundness, that is to say, institutions and rules must represent and be suited to the particular phenomena they have to deal with in a particular country …[T]he best way of strengthening in the long run the centripetal tendencies has been to give so much recognition and play to the centrifugal as may disarm them, and may allow the causes which make for unity to operate quietly without exciting antagonism.[7]

Applying this line of thought to economic law, the first task of the rule-maker is to identify what are the "forces" that are likely to promote, and those that are likely to hamper, the economic result that is thought to be desirable. Having identified those forces, the rule-maker must put in place the mechanisms by which the positive forces can be put to work and the negative forces restrained.

The market economy presupposes that competition between economic operators is a positive force. On the other hand, experience suggests that unrestricted competition may

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6 See generally Garrett Ward Sheldon, *The Political Philosophy of James Madison* (Johns Hopkins University Press, 2001) Chapter One, and particularly *The Federalist* Paper Number LI.

7 James Bryce, *The Action of Centripetal and Centrifugal Forces on Political Constitutions*, in: *Studies in History and Jurisprudence* (Oxford, 1901) p. 216 ff., at p. 217, 218 and 220.

produce undesirable results. Survival of the strongest and most ruthless is not necessarily the same, nor as economically desirable, as survival of the fittest. If the positive forces of competition are to work, competition must be fair, and the conditions of competition must not (in the words of Article 3(g) of the original EEC Treaty) be "distorted", whether by the actions of economic actors or by those of states.

It is now generally accepted in the western liberal democracies that two basic rules are required to achieve the benefits of competition while restraining the potentially harmful effects of unrestricted competition. These are, first, that anti-competitive agreements and practices between economic operators should be outlawed and, second, that economically powerful operators should not be allowed to "monopolise" the market (the Sherman Act) or "abuse a dominant position" (the EEC Treaty). In order to ensure observance of these rules, antitrust or competition regulators are invested with powers to investigate, to issue orders and, in some cases, to impose financial penalties. Such powers are liable themselves to be abused, so the regulators must themselves be subject to control by the courts. It is only if these checks and balances are put in place *and* work effectively that the desired economic good will result. This approach can be tested by reference to Articles 81 and 82 of the EC Treaty, which are now reproduced in the legislation of the Member States.

The text of Article 81(1) is, on the face of it, clear. It interdicts any agreement or practice that prevents, restricts or distorts competition. There is no provision in the text for operation of a *de minimis* rule or a "rule of reason". Consequently, if applied literally, the law requires the prohibition of some agreements and practices, even if economic analysis can show that they have a positive economic effect.

As regards Article 82, again the text seems to be clear. The mere existence of a dominant position on the market is not, of itself, economically undesirable or productive of economically damaging results. What is interdicted is "abuse" of such a position. Examples are given of such abuse, notably "directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions". There is, on the other hand, no mention of "exclusionary abuses" or any "theory of harm" underlying the intention of the text such as are discussed in the Commission's discussion paper on the application of Article 82.[8]

In both cases, the question arises whether regulators and the courts should apply and enforce the text strictly and confine themselves to doing so or, on the other hand, import additional economic criteria to supplement the text. In the case of Article 81, a partial answer is provided by Article 81(3) which provides for the prohibition in Article 81(1) to be "declared inapplicable" if certain positive and negative conditions are met. But these conditions require an assessment to be made which is not purely economic. For example, the question whether an agreement "improves the production of goods" or "promotes technical progress" is not exclusively (if at all) a question of economics. Moreover, Article 81(3) does not address the question whether there should be a *de minimis* test or a rule of reason.

It follows that Article 81, as a measure of economic law, may not be an "economic good" for one or both of two reasons: first because the text is insufficiently precise and/or, second, because it is applied and enforced in a manner that is economically inept.

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[8] See DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses (Brussels, 2005)

A more striking illustration of the problem is found in the Commission's Decision in the *Microsoft* case.[9] This raised the question whether a dominant undertaking is required by Article 82 to disclose information to competitors in order to enable them to compete with it. From one point of view, the answer should be positive since the purpose of Article 82 is to promote competition and the presence on the market of a dominant undertaking diminishes or inhibits the free play of competition. From another point of view, competition law is intended to promote innovation and inventiveness and this will not necessarily be achieved by requiring successful undertakings to make available to their competitors the fruits of their innovation and inventiveness. Does the requirement of disclosure "limit technical development" contrary to Article 82, second paragraph, clause (b)?

More generally, the following questions arise:

- Is it the function of the regulator to *regulate the market* or simply to *regulate the conduct of those who operate in the market?*
- What is the proper line of demarcation between the role of the legislator, the role of the regulator and the role of the judge?
- Who is to decide whether competition should give way to moral considerations (e.g. prohibition or control of abortion services or lotteries) or to social considerations (e.g. the availability of health care or legal services, or the right to strike)?

Economic law provides no definitive answer to these questions nor, I would contend, do any supposed laws of economics. There is, as lawyers say, a margin of appreciation and no workable system of economic law can operate without it. The question that needs to be considered, case by case, is to whom the exercise of "appreciation" properly belongs – the legislator, the executive, the regulator, the judiciary or the opinion of economists?

Conclusion

"Economic law" is not a fixed, but a variable concept. Its meaning will depend on who is using the expression and in what context. In particular, those who use it may or may not agree as to what the laws of economics require.

Assuming that economic law means the body of law that is designed to condition the conduct of economic actors, the law-maker will be motivated and guided by a variety of considerations – political (what are the limits of the possible?), social (who should benefit and what desirable or undesirable social results may follow?) and economic (what is likely to be the economic result?). The choice will not be dictated, nor should it be dictated, exclusively by economic criteria.

What matters is that law-makers should be clear about the objectives they wish to pursue and put in place regulatory and other mechanisms that are appropriate to achieve them. These mechanisms should be transparent, objective and impartial. So they must include the checks and balances necessary to avoid arbitrary exercise of regulatory power. But good law and good mechanisms will not, by themselves produce economic good. That depends on human beings.

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[9] Case COMP/C-3/37.792 Microsoft. See also the judgment of the Court of First Instance in Case T-201/04 of 17th September 2007.

Part 2
Across the Fields of Economic Law

Chapter 1
Covering Several Fields

The Notion of Economic Law and Regulatory Competition

Matteo Ortino[*]

This Chapter addresses the subject-matter of this book from a methodological point of view. The aim is to highlight the main features of economic law, understood as the autonomous legal science that studies the interactions between law and economic systems, and its relation with the process of regulatory competition. This paper attempts to provide some elements contributing to the development of the study of both economic law and regulatory competition.

A. Economic Law as an Autonomous Legal Science

Legal rules represent one of the essential components of economic systems. The interactions between the legal component and the system as a whole are the object of study of an autonomous legal science: economic law. Such discipline examines legal rules in relation to the establishment and functioning of economic systems.[1]

With regard to a given economic system, economic law deals, first of all, with the "constitutional" law of such system. Firstly, this entails analysing the relevant rules in order to ascertain the allocation of decisional competences between public authorities and the market. This means determining when, to what extent, to what purpose, and how, public authority, rather than the market, must or may take fundamental economic decisions. Secondly, the "constitutional"-law analysis means delimiting the distribution of decisional competences between the various public authorities that come into play. In international and regional economic systems, such latter analysis concerns the question of when public intervention in the economy must, or may, be carried out at the supranational or international level, and when at the national level.

In sum, the "constitutional" issue regarding the decisional competences concerns a double relationship: one between public authority and the market, the other between the various public authorities.[2]

It is important to clarify that the "constitutional" law of the economy, of a given economic system, concerns the fundamental legal aspects of such system, which include the relationship between the state and the market. The term "constitutional" must be understood in a wide sense, since the legal regulation in which to find the fundamental

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[1] For a comprehensive analysis of economic law, see K. Meessen, *Economic Law in Globalizing Markets* (Kluwer Law International,The Hague 2004)

[2] M. P. Maduro, *We the Court* (Hart Publishing, Oxford 1998).

elements of the economic system is not necessarily of a constitutional nature, as it might also be, for example, of a legislative or of a contractual nature. Those fundamental legal aspects of the economic system that are laid down in proper constituional law rules constitute stronger constraints to political and legislative discretion with respect to public intervention in the economy.

In order to determine if, and to what extent, the public authority and the market possess decisional space, the analysis must include, with regard to a national economic system, constitutional, legislative, and any other norms governing private economic freedoms, and, with regard to the Community economic system, rules such as EC Treaty provisions on the freedom of movements and on competition. As regards the global economic system, the delimitation of decisional competences of the public authority and the market usually gives less clear-cut results compared with what is possible in national and regional economic contexts. This is due to the specific characteristics of the global legal order. However, this does not mean that such delimitation can not be carried out. It is possible, for example, to highlight that, in the last decades, the decisional space of the market has widened. Evidence of that is provided by the expansion of the new *lex mercatoria*, of the law-shopping carried out by transnational firms, and by the progressive reduction of legal obstacles to international trade through the work carried out in organizations such as the WTO.

The "constitutional" analysis concerns what can be referred to as the "general part" of the economic law discipline. It is aimed at ascertaining, by examining the relevant law, the fundamental features of the economic system as a whole. Such features are summed up in questions such as: When may or must the public authority take decisions instead of the market? For what purposes? How may the public authority intervene on the market? What are the limits? etc. Economic law is interested in economic-system related goals of public intervention in the market, such as economic development, international trade liberalisation, financial stability, and protectionism. The analysis of such goals is of fundamental importance for the purposes of economic law studies. The general structure of the legal and economic system changes, in time and space, depending on the purposes pursued by the public authority and on the way such purposes are pursued. It is not possible to comprehend the structure of an economic system if not through an analysis that includes the "constitutional" purposes and modes of public intervention in the economy. Public authority might intervene to the same extent, but for different purposes and in different ways. Take, for example, banking regulation in European countries. Compared with recent past regulation, rules imposed by public authorities on banks have not changed in quantitative terms; however, as the regulatory state has replaced the dirigist state, the purposes and the characteristics of public intervention in the banking sector have changed considerably.

The assessment of the "constitutional" law of an economic system takes as the first criterion the *suitability* – in terms of effectiveness and efficiency – of public authorities' competences – in terms of decisional space taken from the market, and of how such competences are exercised to achieve such goals – in relation to the pursued goals. Effectiveness means the capacity to achieve the goals that are pursued; while efficiency concerns the economic costs, the economic resources, necessary to achieve a given goal. Therefore, a regulation is effective if it fully achieves its objectives; and it is the most efficient if there is no alternative way to achieve the same result at lower costs.

With regard to public authority's competences, the economic law assessment deals with both the issue of the decisional space taken away from the market (how effective and

efficient are the results achieved by the public authority compared with those that can be achieved by market forces?), and of the specific modes of public intervention – including the decision to have a certain authority intervening rather than others – in order to achieve the pursued goals (How effective and efficient are such modes in comparison with alternative modes, such as, for example, relying on international regulatory cooperation instead of regulating unilaterally?).

For example, if, within a certain legal and economic system, environmentally sustainable economic development is a constitutional objective of public intervention in the economy, the first valuation carried out by the economic-law analysis is to verify the effectiveness and the efficiency of the legal instruments employed to achieve such goal, eventually highlighting the higher level effectiveness and/or efficiency of choosing to leave more freedom to market forces and/or setting up a different public intervention.

It is necessary to underline that efficiency, not only constitutes – as just explained – an assessment criterion that can be used in relation to other objectives. It also represents in itself an objective pursued within a given economic system. The various sets of rules aimed at correcting market failures, such as competition law rules, aim at safeguarding the efficient functioning of the market. In these cases, economic law evaluates if, and to what extent, the consequences produced by the law effectively protect market efficiency. It is evident that in such instances efficiency and effectiveness coincide.

To the extent that economic law carries out an assessment concerning the efficiency of legal rules governing economic activities, reliance is made to the Law and Economics approach and studies. In this sense, there is a partial overlap between the two legal disciplines, which, however, for the other aspects, remain distinct and different. It should be enough in this regard to stress that economic law, unlike Law and Economics, is not concerned exclusively with the economic efficiency of legal rules.

In addition to a "general part", the discipline of economic law also comprises a "special part". It focuses on specific components of a given economic system (eg, financial or agricultural markets), or individual "economic issues" present therein (eg, the protection of economic competition and of consumers). Of these components and issues economic law examines the fundamental legal aspects, in relation to the economic system as a whole. From the economic law point of view, the object of such exam includes the *allocation of decisional competences* between the public authority and the market in relation to such specific components and issues, the *goals* pursued, the *way* such competences are exercised and the relative *limits*. Such analysis can have different purposes, including, the examination and assessment of the compatibility of such allocation with that resulting at the general level, that is, at the constitutional level. Other purposes may be the examination and assessment of the effectiveness and efficiency of the former; and the delimitation and evaluation, in terms of efficiency and effectiveness, of the specific objectives pursued or that might be pursued by the public authority – also in relation to the objectives pursued "in general" in the same economic system –, and the legal instruments used or that might be used.

B. The Specific Features of Economic Law

What said above about economic law – in its "general" and "special" parts – introduces the explanation of the principal characteristics of such analytical method. Such method adopts an approach that is *functional*, *transversal* and *open*. It is functional in the sense that it addresses the role of law with respect to the solution of specific issues or problems connected to the functioning of economic systems. From such perspective, economic law adopts a transversal approach with respect to sources of law, traditional legal disciplines and jurisdictions, and it adopts a wide notion of law.

Economic law addresses specific problematic aspects of the economic system on the basis of an unitary perspective and of a systematic analysis of the relevant legal institutions. To this end, economic law goes beyond the traditional boundaries between the various legal disciplines, such as private and public law, substantive and procedural law, and, if necessary (as it is increasingly the case nowadays) between various jurisdictions, such as national, international, supranational, transnational law. In order to understand the functions of economic law, no source of law and no jurisdiction can be set aside *a priori*. For economic law purposes, the study of law should be divided by problematic areas, rather than by sources, legal disciplines or jurisdictions.[3]

Economic law examines single economic aspects or issues of the economic system in order to understand and assess (from a positive and normative point of view) the relation between such aspects and issues, on one hand, and the relevant legal regulation, on the other hand. While describing the general and special part of economic law, some of the problematic areas addressed by economic law have already been mentioned. They include, for example, the allocation of decisional spaces between public authority and the market, the "economic constitutional" goals pursued by the legal system within a given economic system, the legal techniques that can be employed to promote market integration, to increase market competitiveness or the financial stability of an economic system.

As said, economic-law analysis starts with a particular economic issue, and then proceeds to assess the relevant legal rules. Such rules can result from a multiplicity of sources, possibly belonging to a plurality of jurisdictions. The analysis must include all such sources in order to fully understand the relation between law and such economic issues. With respect to the examples mentioned above, market integration, competitiveness and financial stability are all economic objectives that can individually involve a variety of legal sources. As already mentioned above, the "constitutional" law of a national economic system can also comprise legislative or secondary norms, if they are part of the fundamental legal elements of such economic system. Similarly, the sources of the law governing financial intermediation may be of supranational, national and self-regulatory nature.

Rules that are part of distinct legal disciplines (eg, private and public law, constitutional law, commercial law, contractual law, tax law, private international law) are also components of economic law if, and to the extent that, such rules are relevant to the establishment and functioning of an economic system. Economic law is a legal science of synthesis. It combines materials of different disciplines with its own points of view, as it analytically studies and unifies in a single system the legal rules and institutions of an economic system. Unlike the other legal sciences, economic law covers all legal rules that

[3] K. Meessen, *Economic Law in Globalizing Markets* (Kluwer Law International, The Hague 2004) 90.

are relevant to the economic system. All such rules are interpreted and systemised. The goal is to find the intrinsic features deriving from the interactions between the various sets of rules and shaping the functioning of the economic system.

Economic law goes beyond the study of single legal segments in which an economic system is often divided, such as banking legislation or competition law. These latter studies, found in many textbooks, often aim at providing a systematic overview of the whole system by merely placing two or more segments side by side. Economic law, on the other hand, must analyse the economic system in its constituent parts with a view to underlining the proprieties deriving from the complex interactions capable of transforming, extending, limiting the meaning of the single sector-specific legislations.

For example, take the interactions existing in an economic system between the substantive law legislation governing a particular economic sector and the enforcement institutions connected to it. The fundamental purpose of economic law is not pursued if the exams of such two legal areas are simply put side by side without – in the light of economic system-related goals and assessment criteria chosen beforehand – looking for the real effects that such regulations produce on the functioning of the economic sector at issue, and without analysing such regulations in relation to the above-mentioned goals and assssment criteria.

The specific feature of economic law is not limited to what has just been said. Specialists of individual disciplines may decide, as often happens, to interpret some of the rules of their disciplines also from the economic-law perspective, like described above. But these do not constitute proper economic law studies. The latter are studies of private law, commercial law, constitutional law, etc., that, according to the economic law methodology, are bound together by a legal perspective capable of representing the entire economic system as a unitary and connected whole. This task is made possible by a specific characteristic of economic law: unlike the other branches of the law, it undertakes the study of a plurality of legal subject-matters, which are instead usually divided in a variety of legal disciplines. It is with regard to the object of study that is possible to speak of economic law as an interdisciplinary method. The interdisciplinary character does not mean adopting various methods and objectives. Economic law, like all the other legal disciplines, adopts a single and specific analytical method.

In order to be able to regard economic law as an autonomous legal science, it is important to clarify what sets it apart from the other disciplines. In the systemisation, division and interpretation of a legal system carried out by the various legal disciplines, it often happens that a single norm is observed from various perspectives, depending on the purposes and criteria that each discipline proposes and adopts. Banking contract law rules, for example, can be analysed as part of private law, or as part of the special monetary or banking regulation. Economic law does not differ because it deals with specific legal rules, but because it possesses its own assessment criteria and pursues its own objectives.

Economic law differs from both private and public law, in the sense that it cannot be regarded as being a branch of either private or private law. Economic law deals with both private and public law rules, and it does so from its own perspective. Economic law analyses and systematises rules, of a private and public law nature, in their relation with the economic system.

For a long time, economic law has been regarded as a mere branch of public law, without any scientific autonomy. According to that view, economic law more or less coincides with state intervention in the economy. Consequently, economic law did not exist at the time of the liberal State of the XIX century, when economic activities were

predominantly left to the private autonomy of individuals and enterprises, and, at the time of the Welfare State, it mainly consisted of the law concerning the economic role and policies of the state (state-controlled enterprises, state monopolies, economic public programmes, etc).

According to a more convincing view, economic law has always existed and does not coincide with state intervention in the economy. Rules governing private economic activities, such as contract and propriety rules, represent a fundamental part of economic law. As the failure of the so-called Washington Consensus has clearly shown, macroeconomic policies of economic liberalisation, privatisation and financial stability, need a legal and institutional base allowing microeconomic development. Such base includes contract law rules enabling economic actors to save on transaction costs, property law, effective mechanisms for the enforcement of contracts and property rights, etc.[4]

Economic law differs from private law as well. This is so not only because the former also addresses public law rules. Economic-law analysis of private law rules is different from private-law analysis. Rules governing contract and property, fundamental institutions of private autonomy, for example, are examined as instruments for shaping the economic system. Under this perspective, political power integrates rules on private autonomy with authoritative elements, providing private individuals with general economic tasks, and it also influences the results of the private legal order by setting out various authoritative mechanisms of control or authorisation. Economic-law analysis is not interested in private law objectives and effects other than economic-system related ones.

The same criterion must be applied to differentiate economic law from commercial law, according to whether rules are relevant to the configuration of aspects of the economic system or not. Within the same group of rules dealing with competition between undertakings, provided for by a national civil code, some rules might be more interested in guaranteeing a equitable relation between parties involved in a certain legal situation; while others might especially aim at safeguarding the public economic interest.

As regards constitutional and administrative law, the distinction with economic law is particularly important because the former two disciplines comprise an economic constitutional law and an economic administrative law. For example, a constitutional norm that provides for "the right to carry out private economic activities", in a constitutional law perspective represents a fundamental choice made by the constitution to have an economy in which private individuals' freedom is guaranteed, while in an economic law perspective it represents a choice in favour of free access to entrepreneurial activities, and more generally, to markets.

Similarly, administrative law is usually concerned with economic subject-matters, such as banking supervision, insurance and securities firms. Administrative law rules may be set out to ensure that these sectors are governed coherently and systematically in order to keep the unity of the legal system and to prevent discriminatory treatment among the groups of subject operating in different areas that is not legally justifiable. On the other hand, economic law deals with these rules and institutions, in order to highlight the underlying fundamental economic-system related principles and rationales.

Finally, as the last example, labour law. It was set up as a new legal discipline with a view to studying and systemising in a unitary whole all rules of a legal system concerning individual employees, their legal status vis-à-vis their employers and inside a commercial undertaking, in addition to their relationship with other employees. Special procedural

4 D. W. Arner, *Financial Stability, Economic Growth, and the Role of Law* (CUP, Cambridge 2007).

rules, set up to protect employees' rights, are also included in this branch of the law. In this perspective, labour relationships constitute a relevant part of the workers' life and are directly connected with their personality. When, on the other hand, labour law becomes object of economic law analysis, the focus shifts toward the activity performed by employees and the price the employer must pay and, counting as a production factor and cost. These legal-economic aspects of labour law clearly emerge when the law provides for collective contracts or the presence of worker representatives in firms' board of directors or of supervisors; or when the current economic globalisation accentuate the consequences on competitiveness of the costs of labour determining the location of firms and foreign investments.

Economic law does not only cross boundaries between legal disciplines, it has a transversal nature also with regard to jurisdictions. Sources of legal rules relevant to economic-law analysis might be found in various jurisdictions: of a national, transnational, regional, supranational or international character. For example, a regulation contributing to shape a given national economic system may have international law as its source. The increasing interdependence between economic systems, as a consequence especially of economic globalisation, has lead to an intensification of the overlapping and intertwining of legal systems. Take, for example, transnational contracts subject simultaneously to several national laws (eg, *depeçage*) and to legal rules established by international commercial practice (eg, *lex mercatoria*). Or, take the functioning of national financial markets, which may be governed by both international law rules (eg, following agreement with the World Bank) and national law.

In addition, economic-law analysis adopts a wide notion of law, which includes measures of different nature and legal effects, not necessarily corresponding to traditional concepts of legal rule. Since the purpose of economic law is to study the interactions between the legal component of the economic system and the economic system as a whole, the analysis must comprise every relevant legal element, even if it does not fit with traditional categories. This is even more important in the current economic reality, in which traditional legal phenomena are often inadequate or insufficient. Take, for example, formally non-binding rules that are nevertheless of fundamental importance for the regulation of certain economic sectors; banking rules laid down by the Basle Committee, or moral suasion instruments employed by supervisory authorities of financial markets; or self-regulation (codes of professional conduct, rules set up by firms managing financial markets), etc. Similar rules, even if they do not result from traditional sources of law, are part of economic law, in that they contribute to regulating the functioning of the economic system, by governing or influencing the conduct of economic actors.

In sum, in order to highlight and assess the role of law in relation to specific system-related issues or questions, economic law adopts an analytical approach that is ready to cross the boundaries between traditional legal disciplines, to go beyond a single jurisdiction and the traditional concept of law. Such an approach is particularly suitable for the legal analysis of current economic systems, in which legal disciplines and legal systems increasingly overlap and intertwine, and in which new form of legal rules come into play. A different method of analysis of such economic systems might not allow a full comprehension of such systems.

In light of the complexities of modern economic law regulation, it is important to stress the importance of the functional, problem-oriented perspective adopted by economic-law analysis. The ever more multi-faceted and articulated character of economic regulation makes it a complex legal bundle. In order to analyse that bundle, the right

approach is to start by specific economic issues, to find all the relevant legal rules, to then reconstruct and assess the solution descending from those rules. If, instead, the economy were to be examined from *a priori* limited point of view, confined within single traditional legal disciplines or single jurisdictions, the effectiveness of the analysis is put at risk.

C. Regulatory Competition

Regulatory competition represents one of the most important aspects of the current process of economic globalisation. The expression "regulatory competition" is used here in a broad sense, to refer to the pressure exercised on legal systems (that is, on actors in these legal systems) by other legal systems (that is, by actors in these legal systems). The phenomenon may involve a variety of legal systems (of a sub-national, national, federal, supra national and international levels) as well are various types of actors (law-making entities, administrative authorities, courts, self-regulatory entities, etc.). Even though it is not the only one, the competition between national legal systems is the most studied form of competition, and the most relevant to our purposes here.

The word "competition" is used to highlight the analogy with the mechanism of competition between economic enterprises. Entrepreneurs compete in the effort to attract clients and maintain, and possibly increase market shares. National legal systems compete with one another to attract economic resources or professional expertise from abroad, to increase exports of goods, etc. While economic undertakings compete in the offer of a good or service, legal systems compete in the offer of legal rules. There is a market for goods and services, on the one hand, and a market for rules, on the other hand. In fact, the two markets partially coincide. The competition between undertakings, goods and services, necessarily implies also a competition between legal rules, since law is among the elements constituting economic systems. Competition between two goods or two services is also – to a more or less extent, depending on the good or service at issue – competition between the rules governing the production, distribution, etc, of such goods and services. Regulatory competition is based on the legal component of economic systems; the effort is to take advantage of legal differences between legal systems (legal comparative advantages).

Competition, both in legal and in strictly economic terms, puts a pressure on the competing agents to maintain and increase the competitiveness of the goods they offer. As regards economic firms, this means keeping up their own allocative and productive efficiency, in terms of cost reduction, innovation, etc.; while, as regards legal systems, it means keeping the law attuned to the needs of the economy or of certain economic actors.

Generic expressions such as "competitiveness" of law, and "needs of the economy" are used on purpose, since regulatory competition comprises a wide variety of scenarios. Competitive pressure exercised on legal systems may concern many aspects and characteristics of the law. Legal systems may compete in order to make their own law (and thus their own economic systems) more competitive in the field of tax law, company law, labour law, environmental law, etc. In addition, competitiveness may take different meanings: a law may be more competitive than the others, in that it is more efficient, or more complete, or more flexible, or more permissive, or more stringent, etc.

For example, legal systems compete in the export of goods and services, and in attracting firms and capital from abroad. In both cases, legal systems may change rules to

guarantee that the resources available are allocated in the most efficient manner, so as to make the domestic legal and economic system more efficient. To this end, it may be decided to promote and safeguard competition between economic agents, by means of an efficient antitrust regulation or a liberalisation policy; or it may be decided to better the administration or the justice system. To attract foreign investments or increase exports, legal systems may also decide to intervene on production costs, reducing taxes or environment or worker protection burdens.

Regulatory competition between states constitutes one the most important aspect of the economic globalisation process. The global market does not mean a single world market, replacing national markets. The added value attached to globalisation is connected to the possibility – provided by technological developments – of taking advantage of the differences existing between national jurisdictions (as regards the labour market, the capital market, etc.). One the defining characteristics of the current globalisation process is the possibility to locate the various segments of the production chain across the globe, on the basis of the comparative advantage of the different legal and economic systems.

Besides the competition between national legal systems, and more generally between territorially based jurisdictions, for example, between the different states of a federal union, there are other forms of competition. The competitive pressure exists also between non territorial based entities within a single legal system, and between national and supra-national entities.

Between the legislature, the executive and judiciary there may be *de jure* or *de facto* some degree of competition. This may occur also between self-regulatory entities or agencies exercising delegated lawmaking powers: the legislature or the government may decide to deprive an inefficient agency of certain powers and to give them to another agency. This was the case of the Italian banking system: after the recent banking scandals and mismanagements, some of the powers of the Bank of Italy have been given to other supervisory authorities.

As regards the relationships between national and supranational legal systems, there is not the same form of competition existing between national legal systems. However it is possible to highlight a pressure being exercised by a legal system on another with a view to shaping the latter's economic system. In the European context, for example, special interests may "control" state regulator, thus possible intervention by EC institutions may bring the law in line with efficient standards – freeing the market from protectionist (and thus inefficient) forces. In the world economy, WTO law is a useful source of regulatory discipline against protectionist governmental trade policies.

D. Economic Law and Regulatory Competition

Regulatory competition well illustrates the importance of economic-law methodology for the study of economic systems. The economic law analytical approach appears as particularly suitable for examining and understanding such phenomenon.

Regulatory competition, because of its impact on economic regulation, represents one the most important analytical tool on which economic law studies can rely; however it is not the only one, as there are economic law rules that remain untouched by regulatory competition dynamics.

Economic law examines regulatory competition in terms of its effects – be they actual or potential, positive or negative – on the functioning of the economic system. First, a positive analysis must be conducted; a description of the mechanisms of regulatory competition, with a view to highlighting if, how, under what conditions, and to what extent, competitive pressure influences the regulation of economic system and thus their functioning. Second, a normative analysis follows. In relation to the fundamental objectives pursued by law in a given economic system (eg, economic efficiency, market integration, environment-friendly economic development), economic law analysis addresses the question as to if, to what extent and how, regulatory competition should be promoted, precluded, limited or combined with other legal instruments. In other words, the relationship between the mechanism of regulatory competition and the achievement of the fundamental objectives underlying the legal-economic system must be evaluated.

As regards what has just been said, it is important to stress that other regulatory instruments can come into play in order to enable or develop regulatory competition, or, instead, to limit or substitute the latter. Cooperation between legal systems (or between actors in these legal systems) is the legal technique most referred to in this regard. In the form of regulatory harmonisation or unification, regulatory cooperation – like regulatory competition – constitutes a legal technique that can have a (positive or negative) impact on the functioning of economic systems, and thus can be studied by economic law. There can be cases where regulatory competition on its own cannot achieve its objectives, and consequently must be accompanied or substituted by regulatory cooperation.

In the EC financial law system, for example, two regulatory strategies have been adopted in the last twenty years or so, to achieve the harmonisation of national laws, and thus the creation of the internal market. From the mid-eighties to the beginning of the XXI century, the strategy was based on the so-called "new approach": it left ample room to individual national regulators, relying mainly on national regulatory competition, which was supposed to lead to a bottom-up convergence of national laws. The at least partial failure of such an approach (and of regulatory competition as the principal convergence factor) has prompted the adoption of another strategy, the so-called Lamfalussy procedure, that, instead, has increased the degree of regulation laid down at EC level.

The above provides proof of the particular suitability of economic law for studying the regulatory competition phenomenon. The fundamental characters of economic law make such discipline particularly useful in addressing the analysis and the understanding of such phenomenon.

First, regulatory competition, just like economic law, concerns simultaneously a plurality of legal disciplines, of legal sources and of jurisdictions. National regulatory competition, for example, is not limited to a competition between single sets of rules. Every legal order takes part in the competition with a heterogeneous plurality of regulations. For example, one of the most interesting and important regulatory competition is between global financial centres. Bevor the sub-prime financial crisis New York is losing market shares to other centres, like London and Hong Kong. This was not simply due to a single law governing a specific aspect of financial markets. It was rather the result of a combination of various and different sets of rules, regarding areas as diverse as accounting and immigration. For a proper analysis of the competition between financial markets law it is thus necessary to adopt a "transversal" approach, such as the one adopted by economic law, capable of covering all the relevant laws, irrespective of the borders traditionally set up between legal disciplines.

Second, regulatory competition might involve a plurality of actors, not only the legislature, but also, courts, independent administrative authorities in their regulatory and enforcement capacities, etc. Also in addressing this feature, the transversal nature of the economic law approach appears to be particularly suitable. Take the classic example of Delaware as the preferred US State of incorporation. The competitiveness of Delaware state law is the combined result of the actions of various actors, including the state legislature, state courts and law firms, which collectively make the legal system of that State the most effective in attracting the seat of US corporations.

Third, the economic-law methodology is suitable for studying regulatory competition also because of its functional, problem-oriented character. As said, the economic law analysis starts with a system-related issue or problem. The aim is to exam the relative regulation and assess if, and how, law contributes to solving such issue or problem, and thus how it relates to the functioning of the economic system. The best legal instrument (or the best mix of legal instruments) with respect to the solution of an economic issue or question must be determined on a case-by-case basis, depending on the specific economic issue in question. For example, in a certain economic field national regulatory competition may lead to an efficient regulation; this means that in that field, regulatory competition should be protected and promoted. In economic fields where, on the other hand, a similar competition does not have the same results, it should be substituted, or accompanied by other regulatory techniques. In the banking sector, for instance, it is generally believed that competition between national prudential laws is potentially detrimental to the stability and thus to the efficiency of the international banking system. It is for this reason that, through the work of the Basle Committee on banking supervision, international cooperation between regulatory and supervisory national authorities, and regulatory harmonisation are promoted.

The study of the legal instruments used, or that might be used, to promote, limit or exclude regulatory competition, confirms the usefulness of the transversal, interdisciplinary approach of economic law. In the EC legal system, for example, rules of various nature are laid down to prevent those regulatory competitions that cause distortions of economic competition, and thus damage the good functioning of the internal market. To address these cases, the EC law sets out substantive law rules removing national regulatory differences in the field of environmental law that make the cost of producing a certain good much lower in certain States than in others. Or, it sets out private international law rules that make it impossible for an employer to choose the labour law of a Member State to avoid the more severe law applicable in the different State where his employees actually work. Similar examples prove the importance of adopting an interdisciplinary approach to regulatory competition. It is necessary to take into exam the EC regulatory intervention as a whole to be able to understand the interactions between such phenomenon and the EC economic system. If the analysis were to be confined to single sets of rules along the borders of traditional legal disciplines (eg, labour law, administrative law, private international law), it would not be fruitful to address general issues – connected to the economic system as a whole – concerning, for example, the question as to what extent and under what conditions EC law allows for regulatory competition.

This book adopts this type of approach. Specific aspects or areas of economic systems, such as investments, financial systems, economic competition, enforcement of legal obligations, protection of the environment, etc, are analysed from the regulatory competition perspective, in order to assess whether in these areas regulatory competition takes place, and, if so, how and with what legal and economic consequences.

Public Economic Law as the Law of Market Regulation

Stefan Lorenzmeier[*] *& Reiner Schmidt*[**]

Public law governs rules concerning the creation of a national level playing field. If the state or its sub-entities are acting in a public forum to regulate the markets, problems regarding the interplay of market forces and state regulating powers may arise. This contribution tries to elaborate the difficult notion of state regulation in a liberal, market-orientated system on the national, European and international level. The multi-layer system provides many opportunities for states to influence the level playing field and leads to a competition of different economic systems in front of the background of global harmonisation of competition laws.[1] Dogmatically, countries in Europe are usually influencing this field by using their national administrative law.

A. Administrative Law as Economic Law

The role of administrative law has developed from one of an interpretative science into that of an action or decision science oriented to law making.[2] This means that the perspective regarding the classical dogmatic understanding of administrative law must also be broadened. This development in particular has caused the legal world to move towards that of the economic. How this came about, one has to ask in the law about responsible bodies, goals and what can be used to carry out the methods.

Of the many reasons for this, the first that should be mentioned are privatisation and deregulation. Administrative law freed itself from its role of an interpretative science interested in the application of the law and now aids, within its new scope, in making decisions that are aimed at making laws and solving problems. Both fields of learning are connected in that their method by which they steer the system requires a subject who guides – an actor – a guided object to be influenced and a goal, at which the guiding should aim.

With somewhat different priorities, the governance debate looks less at the actors and more at the structure of the rules in which governmental and nongovernmental actors interact.[3] Although it has not been clarified to this day what is to be understood by governance, it appears to be safe to say: governance refers to the mode and quality of

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1 K. M. Meessen, *Wirtschaftsrecht im Wettbewerb der Systeme* (Tübingen, 2005) 37 et seq.

2 A. Voßkuhle, *Neue Verwaltungsrechtswissenschaft*, in W. Hoffmann-Riem/E. Schmidt-Aßmann/A. Voßkuhle (eds.), *Grundlagen des Verwaltungsrechts*, vol. 1 (München, 2006) § 1, mn. 15.

3 See I. Appel, *Das Verwaltungsrecht zwischen klassischem dogmatischen Verständnis und steuerungswissenschaftlichem Anspruch*, Referat 2007, 14; A. Voßkuhle (n. 2) § 1 mn. 21.

modern governance, the essential institutional requirements needed for the rule of law and finally the infrastructure of the government and administrative actions.

In this context, the governance approach is of interest inasmuch as it clarifies that these structures of rules interact at government and corporate level. Despite all the newly discovered similarities, the way in which the law works with its core indispensable and clear authority and furthermore with the clearly separate difference between law making and legal application should not be ignored.

B. Regulating the Market

Boiling it down, the essential reforms of a new public law in Germany, in particular a new German administrative law, consist above all of utilising and implementing economic awareness.

This is true for instance for the New Public Management (NPM). In this idea is a bundle of different political reform strategies for increasing efficiency and effectiveness. The concept includes, among others, outsourcing of duties to private undertakings and non-profit organisations, orientating the market through the implementation of competition when creating public benefits and trying to make activities done by public administration competitive again.

The so-called *new control model* is nothing more than a more precise term for the new public management approach with implementation of a cost-performance calculation, budgeting, financial controlling and a fundamental eye towards competition.[4] The concept of regulation also had its origin in economics. Its purpose was the reduction of government influence on the economy and represents the decrease of regulations, the simplification of law and administration and the reduction of the role of the government.

The relationship between the law and economic knowledge is best seen when looking at the goals of the "privatisation wave". Saving money is of the highest importance. This can be done for instance by reducing the cost and price of the public-service goods, introducing fundamentals that support competition and creating of a private service sector. This is to be accomplished for example through a pure privatisation of organisations, i.e. through the administration taking advantage of the private law models (LLCs or PLCs) or through a so-called assets privatisation. In the realisation of this process, private, state or communal property will be transferred over or eventually a true shift of duties to the private sector. Many partial solutions for this are imaginable such as mixed enterprises, mortgaging, commissioning private parties and including private capital when financing infrastructure projects (finance privatisation).[5]

Despite such arrangements, an enormously important responsibility continues to remain with the administration. This entire concept, or as the case may be, the methods such as organisation privatisation, administration cooperation and the like used to carry it out, are dogmatically added to a *guarantee administrative law*, which should stand next

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4 See especially Voßkuhle (n. 2) § 1 mn. 3 ff.

5 See especially H. Bauer, *Privatisierung von Verwaltungsaufgaben*, VVdStRL 54 (Berlin, New York, 1995) 243 ff.

to regulatory law and the right to social benefits as the third pillar of administrative law.[6] This will be further discussed in the following.

The private pursuit of one's interest and governmental implementation of the common good are connected in the concept of a regulative administrative law. This is concerned with optimising the fusion of private freedoms on the one hand and the responsibility of the government to the common good on the other. A regulatory task should specifically allow for an appropriate and equitable price for an activity and ensure that everything is arranged correctly at the same time. In this way this concept of regulation corresponds quite well to the eudemonistic doctrine of the "purpose of the state".[7] The basis is the regulatory framework for the network economies in the areas of electricity and gas supply, post and telecommunications as well as the railway system. The legitimisation for intervening regulation is found when look at the failure of the market. The negative effects of natural monopolies as well as the inclination towards cutthroat price wars need to be counterbalanced. Moreover, the government should try to avoid unjustified expenses from the consumers to the businesses, compensate external effects of market behaviour and remove the asymmetrical distribution of market information.[8]

Regulation can absolutely be in the interest of the economic sector because it replaces monopolies that, while legally prohibited, do exist. Areas do exist, after all, in which only the appropriate intervention by regulations can ensure the availability of the minimum needs (universal services).

German administrative law reacted to this new situation and created regulations that not only set boundaries for lawful interaction but also contain the programmed responsibilities and make the courses of action available. Administrative law can no longer be limited to the categories of lawful and unlawful. Rather, it is aimed at a successful design that can only be judged according to meta-legal standards. In this law, as in the Anglo-American countries, the boundary between public and private law is hardly visible anymore and mixes with the boundaries set by economics. Furthermore, the expectation arises that the citizens contribute their part to ensure successful management.

Regulation in this sense is a modification of the classical economic administrative law. The legal obligations continue to exist; they is simply put into perspective. It amounts to their "gradation".[9] The direction taken by regulations of the administration extends beyond their simple lawfulness; the administration seeks to find the correctness of the laws.[10]

Goals such as the correct content and results, transparency, acceptability, public responsiveness, rationality, efficiency and economics efficiency of the administration behaviour necessarily lead to multidisciplinarity. Economics plays an important role in this. This could be expressed in a more extreme manner by saying the will to fully use the power of society's energy to, from the outset, prevent to the extent possible unwanted private action and reconcile the market forces with other public interest until the correct

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6 C. Franzius, *Der „Gewährleistungsstaat" – Ein neues Leitbild für den sich wandelnden Staat?*, Der Staat 42 (Berlin, 2003) 493 ff.

7 So F. Schorkopf, *Regulierung nach den Grundsätzen des Rechtsstaates*, JZ 2008, 21.

8 A van Aaken, *„Rational Choice" in der Rechtswissenschaft* (Baden-Baden, 2003)

9 I. Appel (n. 3), 27.

10 See E. Schmidt-Aßmann, *Das allgemeine Verwaltungsrecht als Ordnungsidee* (2nd ed Berlin, Heidelberg, 2004) 130 ff.

order is established has lead to regulation – or even all of administrative law – predominately becoming "a science of convenience".[11]

C. Participation of the Government in Competition

Of essential importance for the development of public law as an economic law in Germany was the ability of the public hand to take economic action on its own. Despite the waves of privatisation in federal government, the market power of the states along with the local authorities is still large. According to the yearly "status of holdings" published by the ministry of Finance, the research by the European Centre of Enterprises with Public Participation and of Enterprises of General Economic Interest (CEEP) and the summary from the individual German states regarding their economy, it can be assumed despite the uncertainty in the numerical data that approximately 280,000 persons are presently employed by the federal government and approximately 530,000 by the local authorities. Breweries and mining, commercial and saving banks, and public utilities and transportation services can be listed among the public companies in the federal government. The public hand has the freedom to choose which of the legal persons over whom she governs will be trusted with carrying out the necessary tasks in private law.

The possibility to choose the form of the public company from alternatives offered in private law is predominately supported with the economic and administrative science argument of greater flexibility. The basic problem is where the limits of the public hand exist in economic activity.[12] In Germany it is largely accepted that no general subsidiarity principle exists and that the public hand does not enjoy protection by the constitution. On the other hand, the government not being free of constitutional constrictions also remains undeniable. The government is constrained to promote the general good while at the same time the principle of freedom is withheld from it.

The corporate activity of the public had requires the democratic legitimation. Every official action which is of a decision making character must be responsible to the parliament. For this reason, corporate actions are not exempted from public law constrictions. This necessarily holds to true for the assignment of authority as well. However, according to the controlling opinion in Germany and the established governmental practice, the fiscal administration should not be included in the basic provisions of the allocation of authority found in art. 30, 83 et seq. GG. This can only be supported however when the topic does not regard the discharge of public duty. Because the transition between public-law, private administrative-law and corporate actions is blurred, fiscal action can hardly be ruled out. Because at the end of the day every action of the public hand serves to fulfil a public duty, the extent of the directness or indirectness by which this objective is reached cannot decide on the legal frame of reference. Therefore, there is no reason that fiscal action should be exempted from adherence to the constitutional assignment of authority. If the government cannot find authorisation, that area is left by law to society. If the government wants to take action, a basis of its power is necessary in a federal government even to find out on which level it can act.

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11 So correct Schorkopf (n. 7) 26.

12 Regarding the legal structure of markets see Meessen (n. 1) 24ff.

According to German understanding, public corporations are only allowed to act in the pursuance of public purposes. The aim of realising profits exclusively to improve the state budget is not sufficient. In most cases, a public purpose can however be found, for instance the promotion of investments for economo-political purposes. For this reason, the public purpose is for the most part legally worthless as a general limit on permissibility of the public hand to take economic action on its own. More precise regulation exists with the local authorities. In general, a nexus of public purposes exist between a public purpose, productivity and subsidiarity; this means municipal commercial enterprises have to proportionately complement the productivity of the community, the purpose cannot be carried out better or more economically through something different.

A basic problem of the action taken by the public hand in the economy is found in the question of whether every form of participation in the economic competition is constitutionally relevant. Jurisprudence in this area is not terribly reasonable. It does very little to take into account that the public hand is different than its private competitor colleagues because of its nearly unlimited financial power, its fundamental incapability of incurring bankruptcy and because of the possibility to be able to avail itself to both private and public privileges.

According to the current understanding of the constitution, it has been predominantly realized that every form of participation of the public hand in the economic competition is constitutionally relevant, even though this understanding has not yet been sufficiently recognised by the courts. It is most problematic when the barrier is to be applied beyond which "intervention through competition" is constitutionally protected. It is not only the receiver of a specific intervention that should be regarded as protected. Rather, it should be stopped because of the fact that it negatively influences the individual's personal sphere. Regarding the freedom of occupational choice, the German Constitutional Court (Bundesverfassungsgericht) has clearly said in this context that the particular space of possibilities of individual choice that should be protected by the constitution "can also be touched through regulations, which are capable, because of their tangible effects, of negatively influencing the freedom of occupational choice".[13]

The protection of freedom of competition and the freedom to incorporate requires that they are allowed to work from a defensive point of view when the situation ever is negatively influenced by the government. The space of possibilities of individual choice which follow from private autonomy is not exactly the governments. Lightly felt restrictions do not however mean less of a need for justification. That the government needs legitimation for economic actions cannot however be questioned.

This general realisation has not become accepted in jurisprudence. The attempts to narrow the economic function of the public hand through constitutional guarantees like the guarantee of freedom in art. 2 GG, the freedom of occupational choice in art. 12 GG and the freedom of property in art. 14 GG, partially in connection with the principles of budgetary constitutional law have only been of limited success. Only the law found in the local authority draws clear legal boundaries that have also become effective through jurisprudence.[14]

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[13] BVerfGE 46, 120 (137).

[14] See R. Schmidt, *Die rechtliche Steuerung von Wirtschaftsprozessen durch wirtschaftliche Eigenbetätigung,* in: J. Stelmach/R. Schmidt (eds.), *Krakauer-Augsburger Rechtsstudien*, vol. 3, (Crakow, 2008).

D. Control through the Budget

Originally, the power of the purse was to be understood as an instrument used by parliament to control the administration. The federal budget law should not anticipatorily direct administrative actions and actively influence the administration in a certain direct. It should be used rather to supervise the spending behaviour of the officials. This prospect of controlling the administration has been largely pushed out today. Revenues and expenditures are now calculated within a "system of local responsibility". The separation up to now of financial and property responsibility has been lifted. Flexibility of securities and an eye towards efficient security planning should be mindful of the costs and increase the efficiency of the government's control of the economy. A central importance for the improvement of the safeguarding of resources corresponds in the meantime to the general principle of efficiency (art. 114 para. 2 GG). However, it very much has it limits in light of the governmental budgetary science. According to the *new steering model*, the "need application procedure" should be limited. The financial scope for the budget should instead be delimited by agreements regarding the goals for performance and finances. Within the budget, the budget of the different organisational units should be independently compiled.[15] The organisational combination of financial and property responsibility should lead to a stronger "responsibility to the customer and the market" of the authorities. In other words: budgetary law is no longer limited to the function of "internal law".

Only an analysis of the individual regulations can determine, however, which laws of the budgetary procedure law will act upon the general procedural law and thereby should become more assertive. An example of this would be the public procurement law. This serves in general the regulations of economics and the protection of the bidder.[16]

With the proper perspective, one would come to the conclusion that boundaries have been set for the business modernisation of administration. These are not only in the necessary pursuit of a task concerning the common good of the state, but also in the characteristics of a political administrative guide system. The systematic legal anchoring of the efficiency principle would hide the danger to overlay the entire legal system with economic considerations and would lead to regulation aims and statutory duties being treated as relative and in the end to a weakening of the standards for the regulations.[17]

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15 G. F. Schuppert, *Verwaltungswissenschaft* (Baden-Baden, 2000) 698 ff.; see also C. Franzius, *Modalitäten und Wirkungsfaktoren der Steuerung durch Recht*, in: W. Hoffmann-Riem/E. Schmidt-Aßmann/A. Voßkuhle (eds.), *Grundlagen des Verwaltungsrechts*, vol. 1 (München, 2006) § 4 mn. 64 ff.

16 E. Schmidt-Aßmann (n. 10), 6th chapter, mn. 170 ff.

17 See R. Schmidt, *Flexibilität und Innovationsoffenheit im Bereich der Verwaltungsmaßstäbe*, in: W. Hoffmann-Riem/E. Schmidt-Aßmann (eds.), *Innovation und Flexibilität des Verwaltungshandelns*, (Baden-Baden, 1994) 67 ff.

E. The European Way

The importance of the economic development for the public economic law can be shown in European law.

European law deals with the creation of a common market, not the safeguarding of administrative work. If an administrative action can be qualified as an action of an economic corporation, art. 87 et seq. ECT applies. Agreements which limit competition are precluded as is the abuse of dominant position. Even state aid is excluded. The Member States are not allowed to enact any measures which go against the common market. The public companies are to be treated the same as private ones. The complicated interrelationship between public and private law in Germany is thus abandoned.

The public enterprise is not a part of the administration anymore; financial allocation to a state's own company is treated as state aid on a third party. Public procurement law is also applicable. The application of competition law to actions of the EC Member States ensures that protectionist measures are eliminated and that the resources are efficiently allocated within the EC's single market.[18] The liberalisation of formerly protected markets led to a tension between the introduction of competition on the one hand and the access of citizens to basic needs, like telecommunications, gas and public transport.[19]

The implementation of an administrative task by a public corporation becomes a legal transaction between the administrator and a third party. This has an effect in the end on the behaviour of the corporation found in the public hand, which increasingly following the logic of private management and feel bound to the business rationality and efficiency. Gains become the primary goal. The possibility for cross-subsidies is principally dispensed with. A preference with public acceptance of tender is also dispensed with. The services that were supplied by the government are now carried out within a depoliticised economic regime.

Undertaking in the sense of the ECJ[20] is every entity carrying out an economic activity, independent of its legal form and the type of financing. Because of this broad definition, every administrative action that is supplied for money is seen as economic.

The European law accordingly forms the basis of the free markets ability to adjust itself as a fundamental principle. Privatisation however should however be reached through the principle of "the constructed market", meaning state formation and guidance of markets. An essential regulation model is that of the new network regulation, which is used as the model for example for electricity, gas or the train system. In the area of public personal mass transit, the purchaser principle *(Bestellerprinzip)* is applicable instead. Instead of competition in the market, a competition for the market is organised.[21]

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18 Chalmers and others, *European Union Law* (Cambridge, 2006) 1115.

19 Chalmers and others, (n. 19) 1116.

20 See C. Jung, in: Callies/Ruffert (eds.), *Kommentar zu EU-Vertrag und EG-Vertrag*, 3rd ed. (Munich, 2007) Art. 86 EGV mn. 11 ff.

21 J. Masing, *Die Verfolgung öffentlicher Interessen durch Teilnahme des Staates am Wirtschaftsverkehr – Eine deutsche Perspektive*, EuGRZ 2004, 395 ff.

F. The International Regime Concerning Market Regulation

In the international forum, a state usually tries to regulate the market by using subsidies or state aids, which belong to the most controversial issues. Of particular importance is that the international forum does not constitute a coherent level playing field as established by a nation-state's legal order or the EC's Common Market. The question concerning the harming effect of subsidies is partly political and partly legal.

Subsidies are a transfer of a state's wealth to a private entity which could not survive or would be unable to maintain its standing on the basis of market forces alone.[22] This has direct and sometimes indirect distorting effects on the economy of a third country, because the amount of goods sold from this country will be negatively affected. Yet, according to economic theory, subsidies are not as distorting as other trade instruments like tariffs due to its limited scope of application.[23] Subsidies can be divided into two different groups, export subsidies and domestic subsidies. An export subsidy is a benefit contingent on exports, conferred on a firm by a government. A domestic subsidy on the other hand is any benefit not directly linked to exports.[24] The former are distorting and harmful to international trade, the latter does not necessarily have this effect.[25] This can also be seen from art. 87 ECT, which only prohibits state aids affecting the trade between the EC's Member States.[26]

Generally construed, subsidies can have external and internal effects. Most commonly, they enhance the exportability of products, either directly to an importing country or with this country on the market of a third state which imports the product from both states. Internally, a subsidy may make it more complicated for an exporter to gain the market share in his or her respective state. In such a case, the subsidy act as a tariff as an import barrier.[27]

Moreover, subsidies are, in the practice of the states, one of the most preferred instruments of industrial policy. Usually, a government may want to encourage a certain industry sector to obtain a certain global market share. If this also leads to a production of the good at a considerably lower price, the distortion effect would be zero because the whole world would benefit from this peculiar governmental measure.[28] Despite this result, the welfare-enhancing effect of subsidies on a worldwide scale is limited. Mainly they only lead to protectionism of the domestic industry.[29]

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22 A. Lowenfeld, *International Economic Law* (Oxford, 2002) 200.

23 M. Matsushita/T. Schoenbaum/M. Mavroidis, *The World Trade Organization* (2nd ed. Oxford, 2006) 332.

24 W. Goode, *Dictionary of Trade Policy Terms* (4th ed. Cambridge, 2004) 331.

25 See J. Jackson, *The World Trading System* (2nd ed. Cambridge (USA), 1998) 279 ff.

26 The EC Commission is only scrutinizing subsidies of € 150.000 and more, Commission Reg. 1998/2006 on the application of Articles 87 and 88 of the Treaty to de minimis aid, OJ 2006 L 379/5.

27 A. Lowenfeld, *International Economic Law*, 200; Jackson, *The World Trading System* (2nd ed. 1998) 280 ff.

28 J. Jackson, *The Jurisprudence of GATT and the WTO* (Cambridge, 2000) 92.

29 Concerning external trade subsidies see M. Trebilcock/R. Howse, *The Regulation of International Trade* (2nd ed. London, New York, 1999) 190: "To the United States the [GATT Subsidies] Code is an instrument to control subsidies. To the rest of the world, it is an instrument to control US countervailing duties."

The basic problem for the international legal order is to ascertain the extent to which the states may subsidise their own enterprises. Unlike the legal framework in a nation-state, the multilevel and multi-fragmented international legal order does not constitute an obstacle or prohibition to different trade rules in different states. International law does not proscribe the applicable economic regime to the states; it accepts market economies as well as state economies. As a result, under customary rules of public international law, a subsidy would not amount to an intervention in the affairs of another state. Trade effects are simply not covered by the provision; an international anti-competition law is missing.

Due to the probable distortion effects mentioned above, subsidies are covered legally in most international trade treaties, namely the WTO/GATT-system, which are aimed at creating a coherent level playing field among its members.

G. The WTO/GATT-System

The current WTO-system on the regulation of the market, i.e. the provisions of the GATT and the Agreement on Subsidies and Countervailing Measures, are the outcome of a long negotiating process among the Member States and a vast step towards the establishment of an international market with equal rules for all participants. Although not all of the world's important trading partners are a member of the WTO,[30] the system can be regarded as the first level playing field of worldwide acceptance. A part of the determination of the proper level playing field in the WTO is the already question raised concerning approved and nonapproved state measures for steering the economy.[31] For Germany, the entry into force of the WTO-agreements in 1994 meant that another layer had been added to the multilevel system of its public economic law. This layer for the first time is directly binding upon the European Communities as well, which applied the old GATT 1947 only provisionally.[32]

The drafters of the original GATT 1947 were of the opinion that measures other than tariffs should be discouraged or prohibited, whereas subsidies felt in the first category.[33] The GATT 1947 entailed only cursory provisions regarding subsidies,[34] which had an extremely trade-distorting effect.[35] The GATT 1947 did not define the term "subsidy", an obstacle which could only be partly solved by the plurilateral Tokyo Round Subsidies

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30 Notably in this respect are the CIS-states, which are in promising membership negotiations with the WTO.

31 T. Bender, *Subventionen* in: M. Hilf/S. Oeter, *WTO-Recht* (Baden-Baden, 2005) § 12 mn 2.

32 Only states could become a member of the GATT 1947. Yet, the EC had been granted exclusive external trade powers by its member states (K. Lenaerts/P van Nuffel, *Constitutional Law of the European Union* [2nd ed. London 2005] 828) and became a de facto member of the GATT 1947 (ECJ, Joined Cases 21-24/72, International Fruit Company [1972] ECR 1219.

33 A. Lowenfeld, *International Economic Law*, 201; see also P. Mavroidis, *The General Agreement on Tariffs and Trade* (Oxford, 2005) 178 ff.

34 See C. Pitschas in: H.-J. Prieß/G. Berrisch, *WTO-Handbuch* (Munich, 2003) B.I.12, mn. 1.

35 B. Zampetti, *The Uruguay Round Agreement on Subsidies*, 1995 JWT (29), 5/17 ff.; C. Pitschas (n. 35). For the development of the GATT: J. Jackson, *The Jurisprudence of GATT and the WTO* (Cambridge, 2000) 94.

Code of 1979.[36] The Subsidies Code followed the structure of the GATT 1947 by separately addressing the issues of countervailing duties ("Track I") and export subsidies ("Track II"[37]). Due to political reasons, the Code differentiated between primary and non-primary products, only the industrialised states ratified the Subsidies Code, while most developing nations abstained.

The said shortcomings were at least partly resolved by the Uruguay Round. The 1994 Agreement on Subsidies and Countervailing Measures (SCM) now forms an integral part of the WTO/GATT-System and is a multilateral treaty, binding upon all member states. For the first time the term subsidy is positively defined.[38] The SCM's Annex I consists of an illustrative list of export subsidies. The scope of the SCM is limited to goods and does not entail subsidies for agricultural products[39] and services. A subsidy has to be specific, i.e. the term "subsidy" is limited to state support for certain enterprises and does not cover a support for a whole sector of the economy. This definition closely follows the U.S. countervailing duty law[40] and has been adopted by the EC's anti-state aids law.

The market regulation approach is similar to the one adopted by the EC and the U.S. and so reflects the Western, free trade liberal view on subsidies. The level playing field is governmental non-action or free, undisturbed market forces and any state measure will disrupt the field. As a result, the national or internal systems in the traditional free market states became the role model for the international system, which sooner or later will be adopted by virtually all states. The SCM also offers the possibility to challenge subsidies. A WTO member can challenge the subsidy as such and can impose countervailing duties as well, when some additional requirements are met.[41]

The SCM applies the so-called traffic-light-approach by dividing subsidies into three categories, prohibited (red), actionable (yellow) and non-actionable (green).[42] This is an important development from the Tokyo system. Art. 3 SCM contains the prohibited subsidies. A subsidy is prohibited if it is conditional upon export performance or upon local content requirements. The illustrative list of export subsidies entailed in Annex I of

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36 Agreement on the Interpretation and Application of articles VI, XVI and XXIII GATT, BISD 26S/56 (1980); M. Trebilcock/R. Howse (n. 30) 192 ff. The first "institutional definition" of a subsidy can be found in the GATT Panel Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in France, Germany and the United Kingdom*, (15 November 1994) SCM/185; also: P. Mavroidis (n. 34), *The General Agreement on Tariffs and Trade* (Oxford 2005) 179.

37 Track II entailed for the first time requirements for defining a subsidy, which were not necessarily also applicable for Track I.

38 Art 1 SCM provides that "a subsidy shall be deemed to exist if (a1) there is a financial contribution by a government or any public body within the territory of a Member […] or (a2) there is any form of price support in the sense of Art XVI GATT 1994; and (b) a benefit is thereby conferred." The GATS also contains a (much weaker) provision concerning the prohibition of subsidies, Art XV GATS.

39 These issues are regulated in the Agreement on Agriculture, which is lex specialis to the SCM. Agricultural issues form a major point in the ongoing Doha Round negotiations.

40 M. Trebilcock/R. Howse (n. 30) 195.

41 M. Matsushita/T. Schoenbaum/P. Mavroidis (n. 24) 335.

42 J. Jackson (n. 26) (2nd ed. 1998) 290. The non-actionable subsidies laid down in Art 8 para 2 SCM (regional aid, research, development, environment) were only of a transitional character and are no longer in existence.

the SCM is not exhaustive. Measures not named can also qualify as prohibited subsidies if it can be proven that it amounts to a *de jure* or *de facto* subsidy in the meaning of art. 3 SCM.[43] The term "actionable subsidy" is not expressly defined in the SCM. An actionable subsidy according to art. 5 SCM is any subsidy which qualifies as a subsidy under art. 1 and 2 SCM, but which is not regarded as a prohibited subsidy.[44] According to art. 6 (3) SCM this may be inter alia the case if the effect of the subsidy is to impede the import of like products into the market of the subsidising country or where the effect significantly undercuts the price by the subsidised product as compared with the price of a like product of another country in the same market. These effects are assumed if the subsidisation is in excess of a 5 % ad valorem threshold.[45]

Special rules apply for developing countries. Art. 27 SCM expressly acknowledges that subsidies may play an important role in economic development programmes of developing WTO members,[46] which are listed in Annex VII to the agreement. Yet, their right to subsidise is not unrestricted. Developing members only enjoy a special status concerning export subsidies, for domestic subsidies the general rules of the SCM apply. Otherwise the possible distortion of the market would be too extreme.

Moreover, the SCM has also a two-tiered construction of remedies against unlawful subsidies. Countermeasures are either possible multilaterally or unilaterally, which are again sub-divided into measures against a prohibited or an actionable subsidy. According to art 4 (7) SCM, a prohibited subsidy must be withdrawn without delay[47] from the subsidising WTO Member State. If the respective state does not follow the ruling, the Member is permitted to use "appropriate countermeasures".[48] The case law of the DSB establishes a link between the amount of the subsidy paid and the amount of the countermeasure,[49] not to the caused effect. Actionable subsidies must produce an "adverse effect" in the meaning of art. 5 SCM. An injured Member may be authorised to take countermeasures commensurate with the degree and nature of the adverse effects (art. 7 (9) SCM). Thirdly, if the effects are seen in the import market of an injured state, the latter can use

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43 See in this respect the Appellate Body report in the famous case WTO, *United States: Tax Treatment for "Foreign Sale Corporations"– Recourse to Article 21.5 of the DSU by the European Communities – Report of the Appellate Body* (29 January 2002) WT/DS108/RW and the panel report in WTO, *Australia: Subsidies Provided to Producers and Exporters of Automotive Leather- Recourse to Article 21.5 of the* DSU *by the United States – Report of the Panel* (21 January 2000) WT/DS126/RW.

44 M. Matsushita/T. Schoenbaum/P. Mavroidis (n. 24) 364.

45 Art. 6 (1) SCM; see also M. Trebilcock/R. Howse (n. 30) 197.

46 An interpretation can be found in WTO, *Brazil:Export Financing Programme for Aircraft – Report of the Appellate Body* (20 August 1999) WT/DS46/AB/R, para 140ff.

47 The established DSU Panel will determine the necessary time period.

48 Art. 4 (10) SCM, the appropriate measures have to be proportional.

49 WTO, *Brazil: Export Financing Programme for Aircraft – Report of the Appellate Body* (20 August 1999) WT/DS46/AB/R; WTO, *Canada: Measures Affecting the Export of Civilian Aircraft, Report of the Appellate Body*, (20 August 1999) WT/DS70/AB/R; WTO, *United States:Tax Treatment for "Foreign Sales Corporations" – Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement – Decision by the Arbitrators* (30 August 2002) WT/DS108/ARB. An in-depth scrutiny of the FSC-case can be found by R. Hudec, *Industrial Subsidies: Tax Treatment of Foreign Sales Corporations*, in: E.-U. Petersmann/M. Pollack, *Transatlantic Economic Disputes* (2003) 175.

the unilateral option and impose countervailing duties (CVDs), art. 10 et seq[50] SCM. For this, it has to be shown that a subsidy scheme is in existence, that the home industry producing the like product suffered an injury and a causal link between the named requirements exists.[51] CVDs have to be imposed on a non-discriminatory basis on all sources found to be subsidised.[52] Art. 19 (4) SCM requires the calculation of the subsidy on a per unit basis of the subsidised and exported product.

Economically, countervailing duties are profoundly met with some scepticism. They should offset the market distortion caused by the subsidy, but countervailing duties are usually unable to improve the distorted resource allocation.[53] The same could be said for arguments of fairness, because subsidies are disturbing the level playing field and a CVD would again offset this effect.[54] A third rationale for justifying CVDs is that they are improving the position of vulnerable members of the international society; yet – again – they are not meant to achieve such an end. Moreover, according to economic theory, the unilateral nature of CVDs may lead to further protectionist measures and they are unable to distinguish between subsidies which are, from the perspective of international economic law, benign and those which are distortionary to the creation of international welfare.[55] Due to these reasons there is some discussion among economists whether CVDs are really the appropriate means for offsetting the negative impacts of subsidies.[56]

Generally speaking, the WTO is based on the idea of reciprocity. The luring danger is that some governments give way to the pressure of certain interest groups and thereby subsidise the goods. This can only be addressed in a sufficient way by a multilateral approach and not by a bilateral approach aimed at reducing the subsidies of a trading partner.[57] For this, the WTO would become a forum for negotiation and supervision of subsidy regimes, as already exists in the EC. Following this line of thought, it would be recommendable for the WTO to address the reduction of (often bilateral) subsidies and expressly address the economic sectors in a multilateral round like the round on the reduction of tariffs. Due to the vast amount of economic sectors, this would amount to a daunting task which nevertheless would prove successful in reducing subsidies in the long run. This would certainly limit the possibility of states to regulate and promote their own economy at the expense of other economies and a tool for reducing the distorting effects of national public economic law.

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50 See e. g. WTO, *United States Countervailing Measures Concerning Certain Products from the European Communities*, Panel, para. 139.

51 For a detailed analysis see M. Matsushita/T. Schoenbaum/P. Mavroidis (n. 24) 375 ff.

52 WTO, *United States: Final Countervailing Duty Determination With Respect to Certain Softwood Lumber From Canada,* Report of the Appellate Body (17 February 2004) WT/DS257/AB/R para. 152.

53 M. Trebilcock/R. Howse (n. 30) 214.

54 M. Trebilcock/R. Howse (n. 30) 214 ff.

55 M. Trebilcock/R. Howse (n. 30) 217.

56 R. Behboodi, *The Regulation of Subsidies in International Trade*, London, 1995; R. Diamond, *A Search for Financial and Economic Principles in the Administration of Countervailing Duty Law* (1990) 21 Law & Policy in International Business, 723 et seq.; R. Diamond, *Economic Foundations of Countervailing Duty Law* (1989) 29 Virginia Journal of International Law, 767 ff.

57 T. Bender (n. 32), in: M. Hilf/S. Oeter, WTO-Recht, § 12, mn. 36.

H. Government Procurement

The WTO Agreement on Government Procurement (GPA), which is a plurilateral agreement and only binding upon the WTO Members who ratified it,[58] deals with the difficult issue of how public procurement contracts can distort the international level playing field. Procurement is defined in Art. 1 (2) GPA as "any contractual means, including through such methods as purchase or as lease, rental or hire purchase, with or without an option to buy, including any combination of products and services."

In most countries the government and its agencies are the largest purchasers of goods of all kinds; it usually accounts for a substantial part of the GDP.[59] Governments are using government procurement for fostering domestic industries. From an economic point of view this may raise procurement costs and reduce incentives to improve and make innovations on the part of the protected industries.[60]

The first Agreement on Government Procurement had been negotiated during the Tokyo Round and entered into force on 1 January 1981. The GPAs purpose is to open up as much of government procurement contracts as possible to international competition. The Uruguay Round brought a considerable expansion of the scope of the GPA, which now also covers i.a. procurement by public utilities. It applies to contracts which are above a certain threshold measured in Special Drawing Rights (SDR).[61] Furthermore it holds the principles of national treatment and non-discrimination, but only in cases of direct reciprocity. Each member has to determine the scope of application for the respective member, which are laid down in an Appendix to the GPA.

The Agreement's main weakness is its plurilateral character and its low acceptance among the WTO Members. During the negotiations the participating countries were unwilling to give up the tool of government procurement for supporting domestic industries. Hence, the effect of the improvements, especially the extension of the GPA's scope to central and sub-central agencies[62] and the broadening of covered activities, does not lead to a multilateral level playing field. This is limited to the developed states. Unlike the EC legal system, the protection against unfair government procurement internationally is rather weak and incoherent, which constitutes a considerable obstacle for a liberal trading and service[63] system.

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58 To date, the Agreement has only 28 Members, mostly developed states.

59 It is estimated that it accounts for at least 10 % of the GDP in most countries, W. Goode (n. 25) 159.

60 M. Matsushita/T. Schoenbaum/P. Mavroidis (n. 24) 741.

61 For central government purchases of goods and services, the threshold is SDR 130,000; for purchases of goods and services by sub-central government entities the threshold varies but is generally in the region of SDR 200,000. For utilities, thresholds for goods and services is generally in the area of SDR 400,000 and for construction contracts, in general the threshold value is SDR 5,000,000, for further details see: www.wto.org, public procurement.

62 M. Trebilcock/R. Howse (n. 30) 202.

63 See Art XIII GATS.

J. Conclusion

Public economic law is a feasible instrument for the regulation of national markets. In an ever more globalised and inter-dependent world it may nevertheless cause frictions and disturb the international level playing field as it does in the national arena. Yet, the reasons for justifying or offsetting the caused problems by state interventions are diametrically different. On a national level, an elected government controls the administration, whose aim is to secure the welfare gains of a national economy. In this respect, a state is free to reallocate its own resources and reorganise its level playing field within the constraints of its national legal order. This situation is substantially different on the international arena. The EC as well as the WTO create a level playing field, independent of its Member States, with its own rules, which can be easily distorted by the Member's subsidies. The adverse effect is that a Member has to respect another layer of constraints for its national economic policy. A brilliant example for this are services of general economic interest and government procurement,[64] two classical means of national economic policy. Balancing the necessity of state action with a liberal trading system is extremely difficult on the international level because the needs of the states differ vastly,[65] For achieving a "fair" law of international subsidies, the proposed attitude seems to be apt for overcoming the stated problems. The imposition of an international competition law[66] is, notably in front of the background of an ever-closer and more integrated international community, one of the greatest tasks for the future of international economic law. Such international competition law should go beyond the classic notion of competition law and address political measures that are only indirectly harming the liberal market forces as well. Other prerequisites for a true international level playing field are similar environmental and social standards, an idea which cannot be developed further in this contribution.[67] The challenges for national administrative laws are ahead.

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64 In the meaning of Art 16 and Art 86 (2) ECT.

65 In this regard the EC has to be distinguished from the WTO because the interests and needs of the Members States are roughly equal.

66 See E. Koch, *Internationale Wirtschaftsbeziehungen* (3rd ed. Munich, 2006) 183 ff.

67 An illustrative example is the decision in the *EC-Biotech* (*WTO, European Communities – Measures Affecting the Approval and Marketing of Biotech Products*, Report of the Panel (29 September 2006) WT/DS291-293/R) case.

Competition in the Private Enforcement of Regulatory Law

Hannah L. Buxbaum[*]

The expanding literature on interjurisdictional competition in the area of public economic law focuses on competition among substantive regulatory regimes. Building on the substantial body of work on competition for corporate charters, this literature examines the potential benefits of competition in other areas such as securities regulation or insolvency law.[1] This comment will address the *private enforcement* of economic law, inquiring whether some form of systems competition might be developing in that area as well – that is, competition among legal regimes with respect to the remedies available to private plaintiffs in claims arising from violations of regulatory law, as well as the procedural framework in which those remedies are sought. Using the U.S. system as a point of departure for this inquiry, it will examine two different forms of competition. The first, which may be characterized as a form of yardstick competition, refers simply to the process of comparative analysis through which certain rules emerge as models for other systems considering regulatory reform, or as templates for instruments of formal regional or global harmonization. The second is a form that in the area of private regulatory enforcement is – perhaps, and at most – nascent: competition to attract private claims when the claimholders are free to choose one regime over another. The latter form of competition would manifest itself if a plaintiff's private cause of action for damages resulting from a defendant's breach of regulatory law could be asserted in at least two different jurisdictions. In that case, in selecting the forum in which to bring its claim, the plaintiff would choose a particular set of remedial and procedural rules over another, creating the conditions for interjurisdictional competition.

A. Yardstick competition

It is fair to characterize the U.S. regime of private enforcement of regulatory law as the most fully developed among modern systems. Until relatively recently, however, it was rarely used as a model, either by other nations seeking to strengthen their own enforcement regimes or in the process of regional or international harmonization. To the contrary, it was very much an outlier among regulatory systems – despite the fact that substantive U.S. regulatory policies were otherwise quite important in influencing law development elsewhere.

In the competition law area, for example, the right of injured plaintiffs to sue for private compensation (as well as the incentive of multiple damages to encourage such

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[1] *See infra* notes 9-12 and accompanying text.

suits) was an integral part of the U.S. enforcement regime already from its inception.[2] Yet during the post-war period, when U.S. antitrust policies were otherwise quite influential in the shaping of competition laws in other jurisdictions, the private enforcement mechanism was not taken up as part of any substantive convergence.[3] The same is true in the area of securities regulation. Many of the reform and modernization initiatives undertaken in other countries reflect the influence of policies underpinning U.S. securities law; in addition, harmonized instruments such as international accounting standards and international disclosure standards reflect the influence of U.S. rules.[4] However, as in the competition law context, private enforcement has not been taken up to the same extent as the substantive norms. The reliance on private lawsuits – both shareholder derivative litigation and securities fraud actions brought by investors – as a major regulatory tool (not just as a theoretically available cause of action) has long remained essentially an American habit only.

The reasons that private enforcement of regulatory law did not emerge through the process of yardstick competition as a model for other systems are well rehearsed, and I will mention them only briefly here. They include the historical preference of many legal systems for public rather than private regulation, as well as widely shared policies against the award of private damages for anything other than purely compensatory purposes. In addition, and perhaps most importantly in practical terms, robust private enforcement depends on certain procedural mechanisms that are present in the United States but not in most other civil justice systems. Structures facilitating the full-fledged private enforcement system as it exists in the United States include the modern class action mechanism, adopted in 1966; the contingency fee, long available to U.S. attorneys; and discovery rules capable of offsetting the information asymmetry that often frustrates plaintiffs in regulatory cases. While the U.S. civil procedure framework was not constructed in order to facilitate private enforcement of regulatory law, it presented the conditions within which private enforcement could flourish. Given that other countries – entirely independently of regulatory policy – simply lacked those procedural conditions, it is not surprising that this aspect of the U.S. regulatory system did not historically win favor elsewhere.

This situation is changing. Indeed, there is interest in some European quarters in introducing U.S.-style litigation structures for the specific purpose of encouraging private enforcement of regulatory law. The Commission has emphasized the need to adopt new procedures in order to promote private enforcement of anti-cartel and consumer law;[5] in addition, many countries within and outside Europe are considering the adoption of group litigation processes closer to the U.S. class action model than to other, more

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2 *See* Edward Cavanagh, *Antitrust Remedies Revisited*, 84 Or. L. Rev. 147 (2005) (discussing the legislative history relevant to antitrust remedies).

3 *See* Hannah L. Buxbaum, *German Legal Culture and the Globalization of Competition Law: A Historical Perspective on the Expansion of Private Antitrust Enforcement*, 23 Berkeley J. Int'l L. 474 (2005).

4 *See generally* Amir N. Licht, *International Diversity in Securities Regulation: Roadblocks on the Way to Convergence*, 20 Cardozo L. Rev. 227 (1998).

5 White Paper on damages actions for breach of the EC antitrust rules, COM(2008) 165 final of 2 April 2008; *see also* Commission Staff Working Paper accompanying the White Paper on damages actions for breach of the EC antitrust rules, SEC(2008) 404 of 2 April 2008.

traditional forms of collective action mechanisms.[6] Thus, we may be entering an era in which the U.S. private enforcement system becomes part of the process of convergence flowing from this form of competition.

B. Competition in the market for legal claims

The second sense in which we can talk about competition with respect to private enforcement is that of competition between legal regimes to obtain the business of private parties when those parties are free to choose the applicable set of rules. The primary example here is in the area of corporate law, where companies incorporated in the United States, as well as those incorporated in the European Union, increasingly, can select their state of incorporation and therefore all associated rules. Traditionally, of course, there has been no competition of this kind in the area of public economic regulation such as securities or antitrust law. First, the substantive law in these areas was not open to party choice – national regulatory law, a form of mandatory law, necessarily applied within its scope of application and could not be displaced by the parties to a particular transaction. Second, classical doctrines of legislative jurisdiction limited substantially the applicability of one country's regulatory law to transactions or conduct taking place in another. The historic doctrine of territoriality, for instance, which limited application of a country's regulatory law to conduct taking place within that country's borders,[7] operated in essence to maintain national regulation as a closed system in each country. As compared to plaintiffs with purely private-law claims, whose choice of forum is limited by rules regarding personal jurisdiction and venue, plaintiffs with regulatory claims faced additional limitations: because courts would not apply foreign regulatory law, their choice of forum (and therefore of remedial and procedural rules) was limited to the state whose regulatory law was applicable.[8] Thus, plaintiffs seeking to assert claims for compensation under regulatory law were rarely faced with a choice between alternative systems.

Today, however, certain developments signal a relaxation of these limits. In the United States, there is some academic interest, at least, in opening certain public regulatory regimes, including securities regulation and insolvency regulation, to interjurisdictional competition in the same way that corporate law is open to competition. Under this approach, a corporation would be able to select in advance the regime under which an eventual insolvency would be resolved,[9] or under which investors would be permitted to sue it for securities fraud.[10] Assuming that party choice is generally the optimal method of

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6 *See, e.g.*, Louis Degos and Geoffrey V. Morson, *The Reforms of Class Action Lawsuits in Europe Are as Varied as the Nations Themselves*, 29-NOV L.A. Law. 32 (2006) (including a recent survey of European states that have moved toward more expansive procedures for group litigation).

7 The classic articulation of this doctrine in U.S. law is found in American Banana Co. v. United Fruit Co., 213 U.S. 347, 357 (1909).

8 For a discussion of this approach, criticizing its operation in modern systems, see Andreas F. Lowenfeld, *Public Law in the International Arena: Conflict of Laws, International Law, and Some Suggestions For Their Interaction*, Recueil des Cours 1979-II, 311.

9 *See* Robert K. Rasmussen, *A New Approach to Transnational Insolvencies*, 19 Mich. J. Int'l L. 1 (1997).

10 *See* Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. Cal. L. Rev. 903 (1998).

allocating resources,[11] proponents of this view argue that opening such laws to choice by parties both within and outside the enacting state can improve global welfare. They suggest that such competition can promote innovation in regulatory strategies, facilitate the correction of misguided policy-making by providing information about the preferences of regulated entities, and minimize rent-seeking by regulatory agents.[12] If such an approach took hold, then the remedial and procedural rules governing private enforcement – in sectors in which private claims are permitted – would also be subject to competition, as part of the chosen law.[13]

More immediately, assuming that this academic theory does not translate soon into legislation, the turn of other countries toward private law enforcement mechanisms, described above, also raises the possibility of competition among legal regimes for the business of private enforcement. At first blush, as long as economic regulations remain mandatory public law, it would seem that there can be no competition between systems, in the sense of consumption by users of the legal system, because plaintiffs cannot choose which regulations will apply to conduct that harms them. If they are injured in a transaction that causes adverse economic effects only in U.S. markets, U.S. law applies; if the adverse effects are felt only in Germany, German law applies. Yet we already see today some flexibility in this notion, since many regimes recognize not only some form of extraterritorial, effects-based jurisdiction, but also relatively expansive forms of conduct-based jurisdiction that may capture wrongs whose harm is felt in other countries.[14] In other words, the general expansion of permissible bases of legislative jurisdiction has extended the reach of much national regulatory law. Thus, U.S. securities law might apply to conduct taking place within the United States that affects foreign markets, as well as to foreign conduct that affects U.S. markets. Because this expansion creates the potential for overlapping jurisdiction, it also creates the potential that a party harmed by unlawful conduct might have a cause of action under more than one regulatory law. Under certain conditions – where the relevant substantive and procedural laws make the claim more valuable in one jurisdiction than the other – we would expect to see plaintiffs gravitating toward the former system.

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11 *See* Andrew T. Guzman, *Choice of Law: New Foundations*, 90 Geo. L.J. 883, 923 (2002).

12 *See* Roberta Romano, *The Advantage of Competitive Federalism for Securities Regulation* 48-50 (2002). For critiques of such arguments, see Robert A. Prentice, *Regulatory Competition in Securities Law: A Dream (That Should Be) Deferred*, 66 Ohio St. L.J. 1155 (2005); Frederick Tung, *Lost in Translation: From U.S. Corporate Charter Competition to Issuer Choice in International Securities Regulation*, 39 Ga. L. Rev. 525 (2005).

13 To some extent – in claims arising out of contractual relationships – this approach is already developing as a result of courts' willingness to enforce arbitration and forum selection clauses, and governing law clauses, in cases implicating regulatory law. *See, e.g., Bonny v. Society of Lloyd's*, 3 F.3d 156 (7th Cir. 1993) (enforcing such clauses in favor of the United Kingdom in a case brought by a U.S. investor).

14 In some areas, this form of jurisdiction may be legislatively limited: thus, for instance, the Foreign Trade Antitrust Improvements Act limits the reach of U.S. antitrust law to much foreign conduct. In others, it may be interpreted more expansively: see, e.g., Hannah L. Buxbaum, *Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict*, 46 Colum. J. Transnat'l L. 14, 23-25 (2007) (noting the broad application of conduct-based jurisdiction in securities litigation).

Recent litigation arising out of global price-fixing cartels provides a clear illustration of this phenomenon. In a series of cases, including one heard by the U.S. Supreme Court, foreign plaintiffs brought private actions in U.S. courts, under U.S. antitrust law, for damages caused by the activities of cross-border price-fixing cartels.[15] In those cases, the purchasers harmed by price-fixing in transactions outside the United States argued that because the conduct in question had adversely affected both U.S. and foreign markets, and had caused their harm, U.S. law was applicable (in U.S. court) to their claims.[16] The recent spate of securities claims brought by foreign plaintiffs against cross-listed issuers, even where the investment transaction in question took place outside the United States, provides further illustration.[17]

Until now, of course, this has been a one-way business. Although many legal regimes recognize private rights of action under regulatory law, those rights have in most instances remained difficult to effectuate.[18] In a sense, then, the United States has been the only large-scale provider of private remedies. As other systems start to facilitate private enforcement, however, some interjurisdictional competition may develop as to the conditions of that enforcement. It will not be completely open competition – as long as a claim for compensation arising from violations of regulatory law can be initiated only in the courts of a country whose law applies to the conduct in question, plaintiffs will still have to establish the requisite connection with the particular legal system chosen. With the increasingly global nature of economic activity and economic misconduct, however, there will inevitably be circumstances in which more than one country's laws will apply. A limited mobility of legal claims will therefore emerge.

In one particular litigation context, this form of competition has already developed: in securities cases involving the United States and Canada. Both systems permit class actions led by representative plaintiffs. In the common situation in which a Canadian company's securities are listed both on a Canadian stock exchange and in the United States, then, an instance of securities fraud can be expected to generate litigation in both countries. In a traditional, territorial jurisdictional regime, that litigation would be parallel but separate: plaintiffs whose investment transactions occurred on the Canadian stock exchange would participate in the Canadian litigation, while those whose transactions occurred on the U.S. exchange would participate in the U.S. litigation. Due to the

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15 *See* Kruman v. Christie's Int'l P.L.C., 284 F.3d 384 (2nd Cir. 2002) (case brought by purchasers and sellers of art against two major auction houses, based on transactions occurring in England); Den Norske Stats Oljeselskap A.S. v. Heeremac V.O.F., 241 F.3d 420 (5th Cir. 2001) (case brought by a Norwegian oil company against the providers of heavy-lift barge services, based on transactions occurring in the North Sea); Empagran S.A. v. F. Hoffman-LaRoche Ltd., 315 F.3d 338 (D.C. Cir. 2003), *vacated and remanded sub nom*. F. Hoffman-La Roche Ltd. v. Empagran S.A., 542 U.S. 155 (2004) (case brought by purchasers of vitamins against a consortium of pharmaceutical manufacturers, based on transactions occurring in Ecuador, the Ukraine, Australia and Panama).

16 This construction of the relevant antitrust laws was ultimately rejected by the U.S. Supreme Court in F. Hoffman-La Roche Ltd. v. Empagran S.A., 542 U.S. 155 (2004).

17 *See* Buxbaum, *supra* note 14.

18 *See generally* the Ashurst Report prepared in connection with the Commission's 2005 Green Paper on competition enforcement: Study on the conditions of claims for damages in case of infringement of EC competition rules, August 31, 2004, available at http://ec.europa.eu/comm/competition/antitrust/actionsdamages/comparative_report_clean_en.pdf.

expansion in the bases of legislative jurisdiction as understood by U.S. courts, however, Canadian plaintiffs today have a choice: they can join the Canadian litigation, or they can seek instead to join a class action underway in the United States.[19] That action would be governed by substantive U.S. securities law and conducted within the framework of U.S. procedural rules. The plaintiffs might therefore have reason to choose the U.S. action over the Canadian one – for example, to take advantage of more flexible discovery procedures, to avoid the possibility of bearing the defendant's costs,[20] or in the hope of being offered a better settlement.[21] In fact, Canadian plaintiffs in several cases have made this choice, opting for inclusion in U.S. litigation even though a lawsuit in Canada was either ongoing or contemplated.[22]

As other countries adopt broader jurisdictional approaches and more robust mechanisms supporting private enforcement, this form of choice and thus of competition may grow. In Europe, for example, the decision of the English High Court in a case arising out of a global price-fixing scheme permitted plaintiffs who had purchased the relevant goods in foreign markets to sue in English court.[23] As many commentators have pointed out, given certain aspects of the English procedural and remedial structure, this decision may lead European plaintiffs increasingly to English courts.[24]

C. The Future of Competition for Private Regulatory Claims

This developing form of competition in the market for private enforcement is limited in two important respects. First, it can emerge only between regimes that already recognize private rights of action under regulatory law.[25] Second, as noted above, it will necessarily involve a small number of legal systems. Unlike the market for corporate charters, which

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[19] The reverse is probably not true. *See* Philip Anisman & Garry Watson, *Some Comparisons Between Class Actions in Canada and the U.S.: Securities Class Actions, Certification, and Costs*, 3 Canadian Class Action Rev. 467, 521 (2006) ("… an action under [U.S.] Rule 10b-5 may be brought on behalf of all investors, including those who traded in Canada, while an action under the Ontario legislation may not be available to investors who trade outside of Ontario.").

[20] *See id.* at 495-96 (2006) (outlining the costs rule in Ontario courts and noting that the modified loser-pays rule, under which a losing class representative may be ordered to pay the defendant's costs, may "have a chilling effect on class actions generally.").

[21] *Id.* at 521 (noting that because legislation in some Canadian provinces limits the amount of damages recoverable in securities actions, settlement prospects in U.S. courts would often look more favorable).

[22] *See, e.g.,* In re Nortel Networks Corp. Sec. Litig., 2003 WL 22077464 (S.D.N.Y. 2003).

[23] *Provimi Ltd. v. Aventis Animal Nutrition SA,* Queen's Bench Division [2003] [EWHC 1211 (6 May 2003).

[24] *See, e.g.,* Bruce A. Baird, David W. Hull & Steven J. Rosenbaum, *Corporate Leniency Applications*, Antitrust Review of the Americas 2004 at 20, 21 ("Since English courts appear to be more inclined to award higher damages than their counterparts on the Continent and their discovery rules also appear to be more liberal, this judgment may pave the way for the English courts to become the courts of choice by plaintiffs located in other European countries.").

[25] Just as a poker game can begin only when the antes are on the table, competition as to the specific procedural and remedial features of private enforcement can begin only once private claims are recognized in multiple systems.

is completely open, the market for private claims under public regulatory law will remain limited to those systems whose substantive law governs the transaction or conduct in question.[26]

Within those parameters, however, competition for private claims could contribute to the debate as to whether vigorous private enforcement improves the effectiveness of economic regulation. Unlike public regulators, private plaintiffs generally have a one-time incentive, which is to maximize whatever compensation they can receive, either through judgment, or, more likely, through settlement. Therefore, the result of competition for private claims will be to steer private enforcement business to the systems with the most generous remedial rules and the most plaintiff-friendly procedures. This outcome would of course prompt other countries to adopt additional mechanisms facilitating private enforcement only if they conclude that the more private enforcement they have, the more effective their regulatory system will be. The result of such competition would therefore speak to long contested questions such as whether the overall cost of certain mechanisms – such as multiple damages awards or opt-out class action procedures – outstrip their regulatory benefits, or whether vigorous private enforcement negatively affects other aspects of market regulation.[27]

It is unclear, however, whether this form of competition will, or should, develop. A judicial system that entertains foreign claims must expend additional resources in the relevant litigation.[28] Presumably, even systems that choose to promote private enforcement generally would incur those additional costs only if they identified a domestic regulatory benefit in doing so. Some cases and commentators have suggested the possibility of such benefit. In an *amicus curiae* submission to the U.S. Supreme Court in the *vitamin cartel case*, for instance, economists argued that entertaining not only claims based on U.S. transactions but also those based on foreign transactions would increase the total penalty paid by global cartels, resulting in more effective deterrence not only abroad but also within the United States.[29] In addition, though far less significantly, the inclusion of foreign claims would increase the revenues of U.S. firms, such as law firms, providing litigation-related services.[30] Yet as some courts considering such cases have already con-

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26 The group of states involved in such competition could expand, at least as to private claims arising out of contractual relationships, if courts continue to support the enforcement of forum-selection and governing-law clauses in cases implicating regulatory law. *See supra* note 13.

27 In the securities context, for example, many commentators have argued that the risks of private litigation deter issuers from listing in the United States, and therefore diminish the competitiveness of U.S. capital markets as compared with other capital markets. *See* Interim Report of the Committee on Capital Markets Regulation (2006). In antitrust, questions arise regarding the possibility that private litigation may undermine the success of public amnesty programs.

28 This is true even if those claims are appended to a class action initiated by domestic claimants, although in that situation the expenditure is lower.

29 Brief of *Amici Curiae* Economists Joseph E. Stiglitz and Peter R. Orszag in Support of Respondents, *F. Hoffman-LaRoche, Ltd. v. Empagran S.A.*, March 15, 2004, at 19. *See also* Alvin K. Klevorick & Alan O. Sykes, *United States Courts and the Optimal Deterrence of International Cartels: A Welfarist Perspective on Empagran*, in Antitrust Stories (Eleanor M. Fox & Daniel A. Crane eds., 2007) (examining more closely the national welfare effects of private enforcement strategies).

30 In the area of securities litigation, such firms have already been investing in European offices in order to facilitate this flow.

cluded, other considerations, particularly international relations concerns, mitigate these potential benefits. Even limited competition in the market for regulatory claims disrupts the expectations of governments regarding the allocation within the international community of power and authority to address cross-border economic misconduct. In response to such concerns, legislatures and courts – perhaps following the lead of the U.S. Supreme Court in the vitamins litigation itself[31] – may simply choose to revert to a system that more strictly allocates regulatory authority over particular conduct to particular states. Especially because the potential competition for private regulatory claims remains so limited, pursuing the goal of legitimacy in global economic regulation by means of coordination rather than by means of such competition is not unreasonable.[32]

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[31] *See supra* note 16.

[32] It might also shift attention to another solution: a move toward a centralized dispute resolution process intended to channel complicated litigation involving international economic regulation into specialized tribunals. *See, e.g.*, Romano, *supra* note 12, at 164 (discussing the possibility of adopting a "specialized system of international securities arbitration substituting for securities lawsuits."); Karl M. Meessen, *Antitrust Jurisdiction Under Customary International Law*, 78 Am. J. Int'l L. 783, 809-10 (1984) (advocating the establishment of an international arbitral process for use in "controversies regarding the exercise of antitrust jurisdiction").

Chapter 2
Commercial Contracts

Enforcing Contractual Claims: From *Schmitthoff* to Investment Arbitration

Norbert Horn[*]

Preliminary Remarks

The following is a description and analysis of international commercial and economic law and arbitration as the legal and institutional framework for the enforcement of international commercial receivables or claims ("debts"). This is not to difficult a task. But I am not sure to what extent such an analysis contributes to the general subject of the symposium "Law as an economic good". For law is not an economic good in the proper sense, if we talk about law as a general legal and coherent order of rules and its enforcement mechanisms (judiciary, arbitration) and not about individual property rights. Law is not a good that is subject to the price mechanisms of a market. It is, instead, an important part of the institutional framework of markets. Law, moreover, has important economic effects and its formation is influenced by economic considerations. Besides, in the formation of law as well as in its practical use, we find elements of competition in a wider sense, i.e. the competition of systems as mentionned in the second part of the definition of our general subject. In the following, some of these economic aspects and competitive mechanisms will be identified.

A. Towards A Uniform Transnational Law for International Trade and Finance

Law is a prerequisite for commercial transactions. The law defines the objects of commerce (property rights) and allows and protects commercial transactions (contract rights). At the same time, commerce is a promotor of commercial law. Commerce defines the needs and demand for legal protection. *Ubi commercium, ibi ius*. This is a historical lesson that can be learned from the medieval guilds of merchants and their courts that developed a (partially) autonomous and uniform law merchant or *lex mercatoria*.[1] The name of the late German-English law professor *Clive M. Schmitthoff*, who was a protagonist of the modern theory of lex mercatoria[2] and a founding father of the United Nations Commission of

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[1] Benvenuto Stracca, *De mercatura seu mercatore Tractatus*, 1553; Scaccia, *Tractatus de commerciis et cambio,* 1618; Gerard Malynes, *Consuetudo vel lex mercatoria or the ancient law-merchant,* 1622.

[2] Schmitthoff (ed.), *The Sources of the Law of International Trade*, 1964. Cf. also Goldman, *Lex mercatoria et frontières du droit, Archives de Philoophie du Droit vol. 9* (1964) p. 177-192; Horn, *Das Recht der internationalen Anleihen (The Law of International Bond Issues)* (1972) § 19; Horn, *The Use of Transnational Law in the Contract Law of International Trade and Finance*, in Berger (ed.), *The Practice of Transnational Law* (2001) p. 67 et seq.

International Commercial Law (UNCITRAL), may serve as a label for the phenomenon that modern international trade and finance have a need for and a tendency towards developing uniform property rights and contractual patterns, including the use of model contracts and standardized clauses und terms (e.g. Incoterms of the ICC, Paris) in order to facilitate and stabilize international market transactions. International commercial arbitration enhances this development towards uniformity. Uniformity of law can lower transaction costs.

The uniformity of the contract law of international commerce and finance is promoted by international legislation on a global level such as the United Nations Convention on the International Sale of Goods of 1980 (CISG) or the Hague Convention 2002 on Securities held with an Intermediary,[3] and on the level of the European Community. In the realm of private law, i. e. the law of private and commercial contracts and debts as codified, e.g. in the German civil and commercial codes (BGB, HGB) or in the French Code civil and Code de commerce, however, the national codifications or common law cannot simply be replaced by uniform or harmonized European Community law. For private law is not generally subject to community legislation, but only certain areas can be harmonized, namely consumer protection, company law and capital market law.

In addition to international or EC legislation, there are unofficial and not binding codifications of commercial contract law issued by formulating agencies such as the International Chamber of Commerce, Paris (Incoterms, Uniform Customs and Practice of Documentary Credits etc), and Unidroit, Rome (Unidroit Principles of International Commercial Contracts 1995, 2005).

The global and EC endeavours for the unification or harmonization of the law of commercial contracts and debts should not make us forget the simple fact that the international legal order on the level of private and commercial law still consists in a patchwork of different national private and commercial laws. Uniform or harmonized law covers only the smaller part of commercial transactions. Between these different national laws, there exists a certain competition, for the market participants can use their private autonomy to choose the law that suits best their commercial contracts, and the forum where a litigation or arbitration for the settlement of disputes over commercial debts shall be conducted. Accordingly, national legislators in some areas of the law take international competitiveness into account in order to make their country attractive, e.g., as an international banking or financial center or as a good international market place for certain goods and services (including international commercial arbitration) or to offer favourable conditions for investors including a reliable protection of their investment.

We find competiton also within the process towards the unification or harmonization of the law of cross border commercial and financial transactions. The tendency towards unification of the law of international commercial transactions does not eliminate competition as a process to find the optimal legal solution. Competition can be observed on the level of the aforementionned unofficial codifications of transnational legal rules, clauses and contractual patterns. Here, the formulating agencies active in this field are not unfrequently competing for the best solution (e.g., Lando Principles and Unidroit Principles of international commercial contracts). The same sort of competition is found on the level of market participants. As far as they do not act on the basis of unified law

[3] Hague Conference on Private International Law, Convention on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary, www.hcch.net/e/conventions/text36e.html.

(e.g., UN-CISG) or use uniform contractual patterns (model contracts, standard terms), they are free to work out the most efficient contractual patters and insert them in their individual or model contracts. This competition plays a great role in the innovative development of international commercial and financial contracts. A striking example in this respect is the continuing invention of new products (derivatives) for international financial markets.

Vis-à-vis the persisting diversity of national private and commercial laws, international commercial arbitration strongly supports the tendencies towards uniform legal rules, because most arbitrators are willing, in the interpretation of comercial contracts that serve cross border transactions, to overcome a narrow national perspective of the applicable law in favour of an understanding that takes into account the international character of the contract and the observance of good faith in international trade. This is today widely accepted and does not need further explanation. At the same time, the laws and rules of commercial arbitration are developing towards increasing transnational uniformity and a certain autonomy from national laws.[4]

B. States as market participants

States (Governments) and governmental agencies play an important role as participants in international markets for goods, services and capital. The assimilation of the status of states as parties in international commercial and financial transactions to the status of private market participants is a prerequisite of their creditworthiness and thus to their access to international credit and financial markets. As a result of a long and crucial historical development, States have become fully liable parties to private commercial contracts if they participate in commercial transactions and act *iure gestionis* and not *iure imperii*. In this capacity, a State can be sued by its private creditors before the national courts of another State (if the court has jurisdiction because of a valid choice of forum clause or by operation of the law) and the debtor State cannot plead its sovereign immunity.[5] The worldwide recognition of these priciples, however, is not yet achieved.[6]

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4 Lew, *Achieving a Dream. Autonomous Arbitration*, Arb. Int. 22/2, 2006, p. 179 ff. The autonomy of international arbitration, however, is limited by mandatory law, in particular the national procedural law of countries where the recognition and enforcement of an arbitral award is sought.

5 German Constitutional Court, decision of 6. Dec. 1963, 2 BvM 1/62 (Iran-decision), BVerfGE 16, 27 ff., 62 ff.; v. Schönfeld, NJW 1986, 2980, 2984; USA: Foreign Sovereign Immunities Act 1976 of 21. Oct. 1976, in force since 19. Jan. 1977 (28 U.S.C. §§ 1602-1611 (as amended 2002); Great Britain: State Immunity Act 1978 of 22. Nov. 1978; Trendtex Trading Corp. v. Central Bank of Nigeria, 1 AllER (1977), 881; Alcom Ltd v. Republic of Columbia, 2 W.L. R.(1984), 750. France: Carreau, *Droit International* (2e ed., 1988) p. 350.

6 Two international draft conventions on the limitation of state immunity in commercial transactions are not yet in force: (1) UN Convention on Jurisdictional Immunities of States and Their Property, UN Resolution 59/38 of 2. Dec. 2004; (2) European Convention on State Immunity, Basle, of 16. May 1972.

Accordingly, states would often expressly waive such immunity in their contracts, e.g. in the terms of international loans.[7]

In reality, however, many states as debtors do not live up to the high expectations of the market. There remain considerable practical obstacles if a creditor deals with a sovereign State as his debtor.[8] Moreover, the world has witnessed again and again cases where states declared themselves unable to shoulder the burden of their external debts and, accordingly, have declared a moratorium and claimed the restructuring of their foreign debts.[9] The Paris Club that coordinates such restructurings as far as sovereign states as creditors are involved, reports for the time from 1983 through 2006 404 restructurings involving 84 debtor states with a total debt amount of 509 billion US$.[10]

Among the more recent restructuring cases, the Mexican "Tequila crisis" of 1994-1997 and the Argentina crisis of 2001-2002 won some fame. The German Constitutional Court recently had to deal with claims brought by German holders of debentures issued by Argentina before a German court.[11] Argentina had declared a state of emergency because of its economic crisis in 2001/2002 and unilaterally reduced its debts under the great volume of debentures issued as part of international loans.[12] The Draft Rules on State Responsibility formulated by the International Law Commission provide for an limited and temporary exemption from international responsibilities of a State in case of an emergency.[13] The German court invoked by the debenture holders submitted the following questions to the German Constitutional Court: whether a state of emergency empowers a State to refuse payment of a mature foreign payment claim and, if so, whether this is a general rule of public international law to be applied under German constitutional law (Art. 25 GG) as part of German domestic law. The court denied the question and pointed out that the respective Rules on State Responsibility apply only to relations under public international law. This law governs the relations between States or other subjects of public international law and not to contractual relations between a State and private persons (companies) that are nationals of another State. This way, the Constitutional Court, denying the the state of emergency to be a valid defense of the debtor state against the claims of his foreign private creditors, strengthened the

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7 See, e.g., the case decided by the regional court Frankfurt: OLG Frankfurt/M, NJW 2006, 2931: Argentinian Loan with choice of German law and Jurisdiction and an express waiver of immunity as to the execution and enforcement. On the limits of this waiver of immunity regarding accounts used by a diplomatic representation abroad see BVerfG, 6. 12. 2006, 2 BvM 9/03, WM 2007, 57 = DVbl. 2007, 242 ff.

8 On the enforcement of judgements against states, see infra C.

9 On restructurings see Horn, The Restructuring of International Loans and the International Debt Crisis, Int.Bus. Lawyer 1984, 400-409. For recent developments in this area, see Hartwig-Jacob, *Festschrift Horn* (2006) p. 717 et seq. On historical aspects, Borchard/Wynne, *State Insolvency and Foreign Bondholders* (two vol. 1951).

10 Paris Club, see www.clubdeparis.org.

11 German Constitutional Court, 2 BvM 1/03 and ors, 8 May 2007 (dissenting vote *Lübbe-Wolff*) NJW 2007, 2110 et seq., 2114 et seq.

12 Law No. 25.561 of 6. January2002 on the state of national emergency and the reform of the foreign currency exchange system; Regulation No. 256/2002 of 6. February 2002 on the resructuring of international debts and payments and the ordering of a moratorium.

13 Art. 25 Draft Convention on State Responsibility for Internationally Wrongful Acts, United Nations General Assembly A/RES/56/83 v. 12.12.2001.

contractual liability of States toward their foreign creditors. The court admitted that, in international investment claims protected by an investment treaty, things may be different (infra D).

C. Enforcement of contractual claims in international transactions

The development of international trade and finance of a country can be strongly influenced by the question whether debt claims can be enforced in that country. The bad reputation of its judiciary, based on corruption or lack of competence, can have a detrimental effect on the foreign economic relations of that country. The problem, however, has many different aspects. It may well be that a country that is prospering such as China in the last two decades may well attract trade and investment despite its still weak judiciary.

The need to enforce a contractual claim against an unwilling debtor can partially be eliminated in international transactions through contractual arrangements that assure a strictly simultaneous exchange of value against countervalue (e.g. cash on delivery, payment against documents, or letters of credit) or through adequate securities. Nevertheless, the option to enforce a commercial debt against an unwilling debtor is vital in many transactions, e.g. international credit contracts or bond issues.

The recognition and enforcement of judgements on contractual and other debts within the European Community is regulated and harmonized through community law: the former Brussels Convention of 1968 and now the Regulation (EC) No. 44/2001 on Jurisdiction, Recognition and Enforcement of Judgements in Civil and Commercial Matters. There are other regional conventions such as the Lugano Convention. There is, however, no global system of recognition and enforcement of judgements on contractual debts. This means that in many cases a judgement obtained by a creditor in another country than that of the debtor, may find difficulties to have this judgement recognized. The only way to be successful in such a case is to find assets of the debtor suitable for enforcement in the country where the judgement was rendered or where it is recognized.

A particular problem may arise if a judgement against a foreign State is to be enforced and the debtor State pleads immunity with respect to the assets involved. This was the case with German bondholders of Argentinian loans that had obtained a judgement in their favour by a German court and tried to get hold of accounts of the Argentinian embassy in Germany. Here, the question came up and was again submitted to the German Constitutional Court whether enforcement of a commercial debt against a foreign State can be carried out through a seizing of accounts of that State if those accounts serve for the operation of the diplomatic mission of that State in the country of execution, and if the debtor State, in the conditions of the debentures issued by it, waived his sovereign immunity toward the debenture holders in general terms.[14] The Court answered in the negative and said, if the waiver of immunity does not specifically include such accounts, a seizing of these accounts is not permitted by public international law.

The situation is different, when a commercial dispute is decided by a competent arbitral tribunal. An arbitral award can be recognized and enforced worldwide on the basis of the New York Convention of 1958, i.e. in all countries participating in the Convention.

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[14] German Constitutional Court (Bundesverfassungsgericht), 2 BvM 9/03, decision of 6.12.2006, WM 2007, 57 = DVBl. 2007, 242 ff.

This fact together with a bad international reputation of State tribunals in some countries is a strong argument to prefer commercial arbitration to litigation before State courts. If it comes to interim measures, e.g. the preliminary seizing of assets of the asserted debtor in a country where the arbitral tribunal does not have its seat, however, the state courts of that country may be reluctant to lend their support, unless assets of the respondent are located in the country of the court. The judiciary (at least outside the U.S.A.) is not inclined to allow everybody from other countries to freely use its limited ressources.[15]

Moreover, recognition and enforcement is not always an easy way. The state courts play a decisive role in the process of recognition and enforcement. The debtor may object to the recognition or initiate nullity proceedings before a state court. Here again, the quality and integrity of the judiciary that varies from country to country is of vital importance. In the long running and infamously known case *Kahara Bodas Company* (KBC) *v. Pertamina*, a dispute fought out in an UNCITRAL ad hoc proceeding and relating to an investment in a geothermical power plant to be built by KBC in Indonesia, KBC tried to seize sums in US American bank accounts. The CFO of Pertamina declared that these accounts of (Government controlled Pertamina) were assets of the Indonesian Ministry of Finance. KBC could prove the contrary and the District court for the Southern District of New York fined Pertamina 500.000 $ for contempt of court. Pertamina did not appeal the sanctions decision of the court. Later on, Pertamina produced a Cayman Islands court decision alleging that the original arbitral award was obtained through fraud. The 2nd Circuit Court of Appeals eonjoined Pertamina from proceeding with this Cayman Islands judgement.[16]

D. International Investor Protection and Investment Arbitration

Over the last 20 years, States increasingly became aware of the fact that they could attract foreign investors needed for the economic development of their countries only, if they offered them strong and effective legal protection of their investment. The most effective tool to achieve this were and still are multilateral and bilateral investment treaties concluded between States.[17] Today, we find a dense network of bilateral investment treaties (BITs) all over the world that contain such commitments. In addition, there exist multilateral investment treaties, the most comprehensive and most widely used of which is the ICSID Convention on the Establishment of the International Center for the Settlement of Investment Disputes.[18] There are other important multilateral treaties

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15 On March 18, 2008, the English Commercial Court set aside a world wide temporary freezing order granted in January 2008 Mobil Cerro Negro against Venezuelan national oil company Petroleos de Venezuela SA in support of an ICC arbitration with the seat in New York. The court pointed out that, in the absence of any exceptional feature such as fraud, applicant must demonstrate a link with English jurisdiction (assets of respondent located in England; seat of arbitration).

16 500 F. 2d 111, 118 n. 10; comment bei T. Wälde.

17 On the following, see Horn (ed.), *Arbitrating Foreign Investment Disputes*, 2004.

18 Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (Washington Convention), 18 March, 1965, 575 U.N.T.S. 159; ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings, 1984, 1 ICSID Reports 153.

such as the North American Free Trade Agreement (NAFTA)[19] and the Energy Charter Treaty (ECT).[20] Under these treaties, the States agree to give the foreign investor direct claims against the host State under public international law and an option to submit the case to arbitration.[21]

This means that the investor has contractual claims under his concession or investment contract concluded with the host State or its subdivisions (contract claims) and, at the same time, treaty claims under the relevant BIT or multilateral investment treaty (NAFTA). The investor is entitled to initiate arbitration exclusively based on his treaty claims regardless of concurrent contract claims that are to be decided by the comptent local courts. This was established in the ICSID investment case *Aguas de Aconcija and Vivendi against Argentina* (1999-2007). Here, the arbitral tribunal, in a first award, found that it could not decide the case because treaty claims and contract claims were so closely related that the investor should first go to the local courts to obtain a decision on his contract claims. But this award was declared null and void by the competent ICSID ad hoc committee.[22] The arbitration was then won by the investor and the case was terminated before the Argentinian courts successfully in September 2007.

The "mixed" character of investment arbitration between private parties and States and involving private rights protected under public international law typically implies public interests. In a way, investment arbitration is a sort of administrative review of governmental acts.[23] As a consequence, a public discussion was initiated for more transparency of investment arbitral proceedings.[24] In the UNCITRAL/NAFTA investment arbitration cases *Methanex v. United States* and UPS *v. Canada,* the arbitral tribunal found that it had discretion to admit written amici curiae briefs from third parties on the ground of Art. 15 (1) UNCITRAL Arbitration Rules that empowers the tribunal to conduct the arbitration in such a manner as it considers appropriate, provided that the parties are treated with equality and each party is given a full opportunity to present its case.[25] The admission of amici curiae briefs have been practiced also by other arbitral tribunals since.

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19 Between the Governments of Canada, Mexico and the U.S., entered into force 1 January, 1994, 32 I.L.M. 289.

20 Text of the ECT and short comment by *Wälde* in (1995) 34 ILM 360.

21 On this option as a standing offer of the host State to arbitrate, see Cremades, in : Horn (ed.), *Arbitrating Foreign Investment Disputes*, 2004, p. 346 et seq.; Swiss Federal Court, anulment procedure in the (UNCITRAL) arbitration Saluka Investments BV v. Czech Republic, judgement of 7 September 2006, website "Investment Claims" IIC 211 (2006),at 4.1.

22 Compañia de Aguas del Aconquija and Vivendi v. Argentina, ICSID Case Nr. ARB/97/3; award of 21 Nov. 2000, 40 ILM (2001), 426-453 ff.; decision in the nullity proceedings of 3 July 2002, 41 ILM (2002), 1135.

23 Van Harten/Loughlin, *Investment Arbitration as a Species of Global Administrative Law*, 17 Europ. J. Int. L. (2006), 121 ff.

24 Knahr, *Transparency, Third Party Participation and Access to Documents in International Investment Arbitration* (2007) vol. 23 No. 2 Arb. Int. 327-355.

25 Methanex Corp. v. U.S., Decision on petitions to intervene as amici curiae of 15 January 2001; United Parcel Service of America Inc. v. Canada, Decision on petitions for intervention as amici curiae of 17 Oct. 2001. In-depth analysis by *Knahr*, as cited (n. 24).

To improve pre-award disclosure, the circulation of pleadings and hearings transcripts is practiced in NAFTA/UNCITRAL cases.[26] The access of non party stakeholders to attend oral hearings, under Art. 25 (4) UNCITRAL Rules, requires the consent of all parties and, on this basis, has been practiced in some cases. The United States, in their more recent Free Trade Argreements and bilateral investment treaties, provide for hearings open to the public.[27] Post award disclosure of ICSID cases is assured through the regular publication of all awards and other decisions by the Center. When investment claims are submitted to commercial arbitration procedures, no such publication system existed with the exception of NAFTA claims. More recently, however, an unofficial but regular and comprehensive publication in the internet has been established of alle known awards and other decisions in investment cases.[28]

This tendency towards more transparency of investment arbitration is in sharp contrast to the fact that, in commercial arbitration, confidentiality is a particular asset allowing private business partners to settle disputes without public attention. The ICC, on its official arbitration homepage, praises the advantages of commercial arbitration administered by the ICC: "In contrast with ordinary courtroom proceedings under public and media gaze, ICC does not disvulge details of an arbitration case and keeps the identities of the parties completely confidential. So your business remains nobody else's business."[29] The new transparency measures in investment arbitration were critized. Deminished confidentiality can do harm to a party and increase the cost burdens for the parties; besides, public attention may impair the chances for an amicable settlement.[30]

Arbitration on investment disputes based on BITs or NAFTA and conducted under the ICSID Rules or under UNCITRAL Rules or any other ad hoc or institutional arbitration mechanism have proven to be effective tools for the recognition of foreign investor claims.[31] Whilst ICSID provides a self contained system for arbitration and the enforcement of awards, commercial arbitration procedures offer the possibility that enforcement can be carried out with the aid of state courts under the New York Convention. States, however, normally comply with arbitral awards obtained by investors in ICSID proceedings under the treaties. On the other hand, some States are today uneasy with the severe economic losses through such arbitral awards, and there is a certain inclination of some states to escape again the legal and economic burden established by ICSID or by their bilateral investment treaties. But a return to the old regime of *Drago* doctrine and *Calvo*

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[26] United Nations (UNCTAD), Investor-State Disputes Arising From Investment Treaties: A Review (UNCTAD Series on International Investment Policies for Development), 2005, at p. 23.

[27] UNCTAD, Investor-State Disputes, as cited.

[28] See internet site "Investment Arbitration Claims", now published by Oxford University Press.

[29] ICC, official arbitration homepage; http://www.iccwbo.org/court/arbitration/id5327/index.html.

[30] Rubins, *Opening the Investment Arbitration Process; At What Cost? For What Benefit?*, Vienna, UNCIRAL Arbitration Conference, 28. April 2006; Knahr, *Transparency, Third Party Participation and access to Documents in International Investment Arbitration*, 2007 vol. 23/2 Arb. Int. 327-355.

[31] Horn (ed.), *Arbitrating Foreign Investment Disputes* (2004); UNCTAD, Investor-State Disputes, as cited; Horn, *Current Use of the UNCITRAL Arbitration Rules in the Context of Investment Arbitration*, Arb. Int. Vol. 24/4, p. 587-602, 2008.

clauses typical for the period around 1900 and the first half of the 20th century, i.e. to reduce recognition of foreign private debts to a minimum, subjecting them exclusively to the tribunals of the debtor State, is not a serious option. It could exclude the debtor State from international financial markets.

The recent international and national debt crisis of Argentina in 2001/2002 with an official declaration of an economic crisis with accompanying legislation and administrative measures has become a new test case for the effectiveness of international investor protection based on BIT.s and arbitration. Since about 2004, Argentina has been economically recovering. At the same time, it had to accept some arbitral awards ordering a recompensation of foreign investors for legislative and administrative measures during the crisis, that were detrimental to their investment in Argentina and tantamount to expropriation.[32] Argentina till spring 2008 did not pay a cent to honour these awards. It will have to weigh the burden of such arbitral awards against the benefits of an enhancement of its reduced international creditworthiness.

E. Summary

1. In the law of international trade and investment, we observe strong tendencies towards uniformity of the legal and institutional framework; on the other hand, there is a persisting diversity of national private and commercial laws. We find competition in the formation of uniform law, among the different national legislators and in the drafting of contractual patterns by market participants. International commercial arbitration plays an important part in the process towards uniformity of the law of international trade and investment. Unification of the law promises lower transaction costs.
2. States as market participants in international trade and finance have assimilated their legal status to that of private persons. There remain remarkable differences, however. On distinctive feature is that states although not subject to insolvency procedures, not unfrequently suffer from a financial crisis and seek to get rid of at least part of their international debt. Such a crisis can do grievous harm to the international financial markets and to the future market access of that state.
3. The possibility to enforce international claims (debts) in a country, where assets of the debtor are located, is a vital precondition for international trade and investment; shortcomings in this respect diminish a country's access to international markets. In trade, the need to enforce claims can often be avoided through contractual arrangements on the strictly simultaneous exchange of goods and price. As compared with judgements of state courts of a foreign country that can be recognized and enforced on the basis of a fragmented system of bilateral or regional conventions (e.g. EC Regulation No. 44/2001) only, arbitral awards rendered by international arbitral tribunals have the advantage of nearly worldwide recognition and enforcement on the basis of the New York Convention. There remain obstacles, however, as this recognition and enforcement finally depends on the cooperation of state courts.

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[32] CMS Gas Transmission Comp. v. The Republic of Argentina, ICSID ARB/01/8, Award 12.5.2005; comment by *Schill*, From Calvo to CMS, SchiedsVZ 2005, 285; SchiedsVZ 2007, 178 ff.

4. The legal protection of foreign investors in the host country is today assured by many bilateral investments treaties and some important multilateral treaties (ICSID, NAFTA) under public international law. They confer upon the investor the right to sue the host state and initiate arbitral proceedings against it. Investment arbitration today plays an important role. In contrast to commercial arbitration, it exercises a certain indirect control of governmental acts and implies issues of public interest. Investment arbitration can be conducted under the Washington Convention (ICSID) or under commercial arbitration procedures, e.g. under the UNCITRAL Rules. Whilst ICSID provides a self contained system for arbitration and the enforcement of awards, commercial arbitration procedures offer the possibility that enforcement can be carried out with the aid of state courts under the New York Convention.

Dealing with Foreign Governments

Harald Joos[*]

My subject: "Dealing with (Foreign) Governments" is a very broad field. Since in my capacity as a graduated engineer and CEO of a company, I'm not exactly the right person to be giving legal speeches, I intend to focus on the practical side of our daily corporate affairs and will provide you with some examples of why good governmental relations are not only "nice-to-have" when developing business in domestic and foreign markets.

Allow me on this occasion to begin with my most recent business trip that I have just returned from. I had the honour of accompanying our Madame Chancellor as a member of the business delegation to India. Apart from accompanying our Madame Chancellor, which is always something special, the trip to India had a particular significance as this country has become increasingly more important as a trade partner for Germany. Accordingly, the delegation consisted of 30 top managers from different companies of different sizes.

Of primary importance for me and my company, Demag Cranes AG was naturally to be invited to be part of this trip. Thanks to this opportunity, it was possible to establish new ties at the highest levels and shorten decision-making processes und to get to know new aspects and perspectives that will help us develop the market in India, which is so important to us. An invitation to join such a trip is the result of good governmental relations – in this particular case to the decision-makers in German politics. During trips abroad, ties are established and strengthened to foreign governments. These ties are often more important than a letter of recommendation from customers or the best market research.

Two particular subjects were of central interest for us. The first concerned the current import tax of 15 % on certain products and components from abroad. The reason behind this high import tax is that the Indian government seeks to promote domestic production to create jobs. Not least thanks to the pressure already exerted by the German government and German businesses, there is a good chance that the import tax will no longer be imposed next year. The second subject discussed was major infrastructure projects such as airports and ports. The latter is, of course, of great interest to us as we offer, among other things, products and solutions for container handling for terminal operators. I found it quite remarkable that the Indian government reproached the European Union about the high agricultural subsidies that permit agricultural products to be exported to India and sold at lower prices than the domestic products. India primarily views the European Union as an agricultural community. The message was clear: Either you change your ways or we will respond with extremely high import duties!

Allow me to show you in light of other examples from our experience how dealing with foreign governments can present ever new challenges.

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[*] Chief Executive Officer, DemagCranes AG, Düsseldorf. – The paper is a slightly abridged version of an after-dinner-speech delivered at the Düsseldorf Symposium on 2 November 2007.

Let's move from India to China. I would like to describe an example for "dealing with foreign governments" based on our experience in China. We've now been established for 10 years in China. A few years ago, we wanted to expand our business due to growth. At that time, our premises were in a district of Shanghai. We rented the premises from the city and paid our taxes there as well. I paid a call to the Deputy Mayor whom I knew from the past and explained the situation to him. I made it clear that that we appreciated the situation with the location of the premises, but that our dynamic growth would be dampened if we could not expand. And that there are very interesting alternatives in Shenzen and other regions. Shortly after this call, the Head of Business Development contacted me and offered me property in a rice field that was scheduled to be developed into an industrial area. As we acted as an "anchor company" for this project, we received financial support and concessions with regard to the real estate. After not quite two years, the entire rice field was turned into a highly modern industrial quarter and our business is now situated in this exceptional location. What was also important in this case, was our good relationship with some of the functionaries of the Communist Party.

There is no hard and fast rule for dealing with foreign governments. Allow me to demonstrate this by telling you about our experience in South Africa.

Some years ago, the South African government passed the Broad-Based Black Economic Empowerment Act with the aim to promote entrepreneurship among the black people to compensate gradually for the imbalance resulting from the former Apartheid policy. Score cards with different categories were defined to document that companies doing business in South Africa were developing in the correct way. One of these categories concerning shareholding presented a major difficulty for us and other foreign companies. Accordingly, we had to provide proof that the 25 % + 1 percent of the shares were held by "black" investors. At first, this led to more or less to a compulsory surrender as the "sale" did not allow for anything except for well-under-market prices. In addition, interested parties expressed "their willingness" to take on stakes. In the meantime, many companies have joined forces to look for solutions and to make it clear to the government that this regulation is counterproductive in the long run and will lead to companies moving to a different location in another country. At the moment, it appears that an option via investment funds such as, for example, pension plans is shaping up. The pension plans meet the necessary quotas and are interested in investments with high returns. What is interesting is that these investment funds are frequently managed from London. The South African example also demonstrates that there are often major challenges that cannot be met by one company alone. Therefore, making use of relationships and networks is often the only way leading to success.

In conclusion, one could say that the challenges and practices (or customs) in most countries are quite different. Long before an investment decision is made, all the determining factors must be analysed in detail and assessed. Often there is a world of difference between the legal requirements, on the one side and what works in the real world, on the other. The boundary between legal and illegal is easily overstepped in daily business. Recent scandals in the German economy demonstrate the negative attention of the public and media attention and what dimensions of tolerating certain practices can reach and how difficult it is to be consistent in re-directing conduct and process to get them back on the right course. My fellow Members of the Board and I have clearly set the boundaries for Demag Cranes AG and its subsidiaries – a no-tolerance attitude for grey shades of corporate conduct, shady deals, bribery and corruption. Of course, this means that we must, as a consequence, consider in which countries that this course will

be possible long-term and whether it will be a success. This is why it is so essential to check thoroughly in advance.

Summary

Dealing with foreign governments is not a modern issue of the industrial age. Commodity trade has always been a subject of politics. Whether between tribes, towns and cities or countries. Just think of the silk road – a network of trade routes that passed though regions governed by different laws and cultures. At that time, good relationships to the rulers were important or even vital for survival whether for trade or to just simply to pass borders. Fortunately, today, trade wars are, as a rule, not of military nature and are decided at the negotiation table. One thing becomes clear to me over and over again during my many business trips. Good personal relationships cannot be substituted by anything else. Products may change frequently, paragraphs may be stretched and regulations may be one-sided. However, mutual respect and trust and an honest handshake are what count.

Selecting Locations for Investment

A Practioner's View

Klaus Grϋndler[*]

A. Introductory Remarks

As indicated in the title of this paper, its author is not a scientist, but a practitioner. Also, he is not a consultant with broad experience in the field of his contribution gained from many projects in a variety of industries, and he has refrained from undertaking extensive systematic research of the economic and legal literature pertaining to the subject.

Instead, the contents of this chapter are very much based on the author's personal experience relating to projects in the industrial sector, engaged in business to business activities. His experiences include participation in two recent multi-billion euro green-field projects by which completely new factories are built in Brazil and in the United States of America. The conditions relevant for such projects and the experiences gained therein may differ considerably from those prevailing in similar projects relating to fields like banking, insurances, trading or production of consumer products.

To some extent, this contribution relies on publications by institutions or academics relating to the subject.

B. When do companies select locations for investment?

I. Some history

During most of the 19th century, site selection processes and decisions for industrial production purposes were by and large a national phenomenon. While trading across borders may exist for as long as borders themselves, ownership of production facilities in several countries by the same person or legal entity was very rare. Language barriers and cultural differences, legal restraints, the lack of transportation capacities and other limitations impeded both the acquisition of companies in other countries and the creation of new facilities abroad. The activities of European countries, respectively private subjects being residents of European countries in the colonies are of a different character due to the special legal regimes applicable to the colonies.

An early multinational company was the US-based sewing machine producer Singer which, in 1867 and 1871, opened factories in Britain, a country with the same language and a similar legal system as at home. Austria in 1882, Russia in 1902 and Germany in

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1904 followed as truly different countries. The Belgian chemical group Solvay made its first step to Germany in 1880.

In the first half of the 20th century, more steps into the direction of multinational industrial companies were made. Eg, in Germany major foreign investments include the foundation of Ford Motor Company Aktiengesellschaft, Berlin, in 1925 which relocated its production to Cologne in 1931, and the acquisition of Adam Opel AG by General Motors Corporation in 1929. General Motors had intended to produce in Germany already for a while due to the high import tariffs. Also in 1929, Coca-Cola Company which had expanded to Canada, Hawaii and Cuba already in 1896, a few years after its foundation, started production in Essen.[1]

Since the 1960s, multinational industrial companies have become a fact of life and a much discussed phenomenon. The disappearance or at least the reduction of the impediments mentioned above have led to an economic order in which very few countries are left over which are no potential target for an industrial investment.

II. Reasons for foreign investments

Leaving aside site selection situations in a purely national context, one can clearly identify two major situations where a company intends to go abroad and, hence, has to decide where to invest:

1. The move can be primarily cost-driven: A company wants to relocate its production or part of its production from a high-cost to a low-cost country in order to maintain or to improve its competitiveness.
2. Other investments abroad are exclusively or primarily market-driven. Reduced or negative growth expectations in the home market or a deliberate decision to expand into new regions, but also the demand of customers who themselves go global or relocate their factories and want their existing suppliers to follow can be reasons for such a step.

The first motive seems to have been the more important one for many branches of the German and other European industry for quite some time. Especially after the disappearance of the iron curtain in the early 1990s, the enormous differences in labour cost made many companies go east. To some extent, the goods produced in the new factories in Poland, Czechia, Hungary, and so on were sold into these and neighbouring Eastern European markets; but more often, the products manufactured there were afterwards integrated into machines and other goods produced in the home country of the investor and sold there or exported from there. This international division of labour within one group of companies is also called captive off shoring.

Obviously, the incentives and the pressure to relocate production from high-cost to low-cost sites were – and are – particularly high for companies in high-cost countries like Germany and other Northern and Western European countries. As the differences in other cost elements are mostly much smaller than in the case of labour cost, the move was necessary or advisable primarily for labour intensive productions, in particular where the labour force can quickly gain the necessary skills and there are no particular requirements with respect to infrastructure and other elements. By contrast, relocation of production

[1] The Information on individual companies is taken from their internet homepages.

is either not attractive or hardly possible in industries where big plants, high-capital intensity and lower labour intensity are characteristic as, eg, in the steel industry and many parts of the chemical industry.

Recently, reports in both the press and publications of trade associations etc show that the trend for relocation of existing productions from Western to Eastern Europe has lost momentum. While the gap in labour cost diminishes only slowly (with considerable differences between various Eastern European countries), many companies have experienced a lot of unexpected disadvantages of their move which counterbalance the upsides: a slowly reduced gap in productivity, high energy costs, logistical difficulties and others. We can now read about companies which relocate their production to Germany (Here and hereafter, "Germany" stands for the country where a company has its home base or the ultimate parent entity of a group of companies has its headquarters. In most cases, the reference to Germany could easily be replaced by one to any other highly industrialized country.) or which, at least, have decided to have the next extension of their capacities take place at home.[2]

Statistics show that the general perception of the size and directions of cross border investments is only partially true. They do confirm that direct investments in foreign countries as such have increased considerably: Between 1990 and 2005, the worldwide GNP had an average annual growth of 3 %. During the same period, direct investments abroad increased by 11 % per year. The existing direct investments of German companies increased by 580 % between 1990 and 2004.

On the other hand, the statistical data show that most of the direct investment of German companies does not go into Eastern Europe or Asia, but into the European Union and the United States, the established industrial nations. In 2005, the total sum of direct investments abroad held by German companies in the United States was 22 times higher than the one for China, and in the other countries of the Euro-zone it was 21 times higher. On a percentage basis, the other countries of the European Union with its 15 member states as it existed before May 2004 stood for 46 % of the total amount, the United States for 30 %. Growing Asia represented only 6.2 % and the new EU-member states from Central and Eastern Europe 6.4 % (which, however, compares to 0.3 % in 1990). These figures clearly allow the conclusion that, overall, market-driven investments abroad are much more important for German industry than cost-driven ones.[3]

III. Influence of reasons on site selection

At least to some extent, the criteria for selection of a site differ by consequence of the background:

In the case of cost-driven relocations, all countries are potential candidates for an investment, provided that local production costs plus transportation costs to the final destination of the goods produced are lower than the sum of production costs in and

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2 See, eg, "Der Spiegel", 24 September 2007.

3 The statistical data and some other information in this section are taken from the publication Systemkopf Deutschland Plus – *Die Zukunft der Wertschöpfung am Standort Deutschland*, published by BDI – Bundesverband der Deutschen Industrie e.V., Institut der deutschen Wirtschaft Köln, Roland Berger Strategy Consultants and vbw – Vereinigung der Bayerischen Wirtschaft e.V.

transportation costs from Germany. If the goods to be produced at the new site are destined to be integrated into goods produced in Germany, neighbouring countries have an obvious advantage over countries further away. In order to keep invested capital low over the whole production chain, most industrial companies follow a just-in-time concept. Such a concept usually requires reliable (preferably land) transport for parts. This made Eastern European sites particularly attractive for German industrial groups. Similarly, the industrialization of Mexico was fostered by American companies, and Japanese companies looked for new sites in neighbouring Asian countries.

In the case of market-driven investments, the region – that can be an area encompassing exactly one country, or more, or less – is usually pre-selected, because the company wants to fill particular white spots on the global map or wants or has to follow defined customers into defined regions. The former is particularly true for producers of consumer goods who often make strategic decisions in which continents or parts of the world they want to be present. The latter is very often the case for suppliers of the automobile industry.

Another distinction relates to two concepts which use to be called greenfield and brownfield. A greenfield investment means building a new factory on more or less empty land. The term brownfield is used for the acquisition of an existing company or assets which, of course, may be modified thereafter. In some cases, it is clear that only one or the other of these concepts can work. In others, one also has to select between these two alternatives.

C. Selection criteria

I. Indispensable prerequisites

Whereas trade activities are possible in virtually all countries of the world, an industrial investor will exclude an investment at the outset unless certain requirements are met: The absence of war and civil war, an economic system allowing private investment (be it only in the form of a joint venture with a state-owned or other entity based in the respective country), legal rules or agreements with the government providing for the protection of the investment, and a certain stability of the political system which is expected to continue at least during the foreseeable future. In the case of a very high investment, it will also look for some reliability of the judiciary system. However, in many cases industrial companies do not work on the basis of the presumption that they can rely on courts in a foreign country, especially in their relationships with public entities and state-owned companies.

If an investor intends to have the investment financed by private banks or guaranteed by investment protection agencies such as German Euler Hermes, the conditions prescribed by such institutions will also be indispensable prerequisites for an investment decision by the industrial company.

II. Other selection criteria

The weight of all selection criteria not referred to under (I) above in the decision making can vary considerably. The most important criterion is clearly costs. Costs means total costs which are split up into two parts:

1. One time costs for the investment

This encompasses all investment related costs, starting with the purchase price for a site, the preparation of the site, the construction of buildings and infrastructure, the acquisition of machinery including its transportation to the site and erection; going on with cost effects of environmental law requirements such as permits or additional investments prescribed due to environmental protection laws and regulations; up to all ancillary costs connected with the foregoing. Incentives granted by the country, province, or local community involved in connection with the investment, i e state aid can be deducted from the cost of investment and can thereby play a major role in the decision making.

2. Production costs

The second part encompasses all production costs over a defined period of time. The length of this period depends on the kind of investment. In the case of very capital intensive production with long amortization periods, it can be 20 years. Based on existing data including available projections for the future and on certain assumptions, such costs are then estimated for the defined period of time. They include all costs relevant for production of the specific kind starting from the acquisition of raw materials over energy and labour, auxiliary materials and services which have to be bought locally, through taxes. The production costs are then capitalized as in the case of the valuation of a company.

3. Currency exchange rates

Currency exchange rates can have an influence on the calculation which varies from moderate to dramatic. At a very early stage, the investor must decide in which currency he wants to do the calculation. For example, if a European company considers an investment in South America, the currencies of the home country and the country of the investment as well as US dollars can be of relevance. Local costs must be taken into account in local currency, equipment bought from European, Asian, or North American suppliers may have to be paid in euros or US dollars. The prices of raw materials are often US dollar prices worldwide. Finally, the goods produced in the new factory may be exported, totally or partially, to several other countries in which case various currencies can become relevant.

The development of major currencies such as the euro, the US dollar and the Japanese yen in recent years have shown that predictability is very low. Therefore, the calculation process relies heavily on assumptions which may turn out to be false, possibly even soon after having been made. Notwithstanding these uncertainties, the competitive

environment may induce and even force companies to invest in countries with a weak currency, especially if such countries constitute a big market. The recent development of the US dollar provides a typical example: European companies face the situation that their competitive position deteriorates continuously due to the strength of the euro as compared to US companies and, for that matter, Asian competitors invoicing in US dollars, both in the European and in the NAFTA market, and also in the rest of the world. Therefore, they have a strong incentive to invest in the US by acquisitions or greenfield investments.[4]

4. Soft factors

Besides costs, a number of other factors play a role. Which ones, depends very much on the type of production and products the investment is made for, but also on a number of other elements. Hereafter, factors which were found relevant in recent multi-billion investment decisions are described. The order of sequence used hereafter corresponds to the weight attributed to them in those cases. Clearly, there is no magic formula which can be used for all cases. Besides different circumstances, also personal experiences and preferences of the deciders can have quite some influence.

The effectiveness of the supply chain can play a particularly eminent role. Major steel or chemical plants produce millions of tons per year. This means that they also consume millions of tons of raw materials. The availability and reliability of transport capacities for these raw materials is therefore particularly important. Closeness to waterways or at least to effective railroad systems is nearly indispensable. The continuous inflow of the material must not be impeded by influences of nature, political disturbances, strikes or other factors. On the outbound side, closeness to major customers and, again, the reliability of the transport systems are looked for.

The labour force has already been mentioned as an element of production cost. However, cost is by no means the only feature related to human capital which has to be taken into account. The mere availability of the required quantity of workers, engineers, and other required personnel, and even more the availability of labour force of the required quality are also of high importance. Often, the advantage of availability of unskilled personnel at low wages is out-weighed by the lack of engineers and other skilled personnel in the envisaged country or region. If the required personnel is not available in or close to the community of the potential site for the investment, it has to be examined if it is available in other parts of the respective country, in which case mobility becomes a relevant feature. In some countries, like the United States, mobility is generally very high so that it is no major problem to hire many people who have to move when accepting the new job. In other countries, there are considerable impediments to mobility of a wide range, from more general and mentality reasons to very practical problems like housing, different school systems and so on. Obviously, the availability of the required labour force for the ongoing production activities is a primary concern. On the other hand, in the case of a major investment there is mostly also enough time for hiring, accommodating and training such personnel. At the same time, the availability of the required people for the erection of a plant must not be forgotten. Particularly for the

[4] See, eg, "Handelsblatt", 11 March 2008, *Firmen peilen Zukäufe in den USA an* and *Deutsche Firmen bauen US-Geschäft aus*.

construction phase, it is also essential that the personnel of the company and of the suppliers of machinery and other equipment coming from abroad can do their work without major legal or practical impediments such as restrictions contained in immigration laws or burdensome visa rules.

The latter issue is one of the elements of an evaluation category which one can call ease of implementation. This includes a variety of aspects which, in total, can make a big difference for the attractiveness of a site. The erection of a major industrial plant can easily last three years or more from the start of the site preparation, ie not including the mere planning phase. This means that capital expenditure starts many years before the first income is generated by the sale of the products. During all this time, interest on the money already spent must be paid, or at least calculated. Therefore, time is very much of the essence. All factors which have an influence on the time needed for the implementation of the investment decision are therefore relevant, even though it may not be possible to calculate the effects in money terms item by item. Such items include the availability of other production factors for the construction phase than the workforce already referred to, such as machinery for dredging, piling and construction works. It goes on with the rules and practices of the authorities which have to grant building licences, environmental permits, business licences and so on. For example, certain US-states require that companies performing erection works for machinery at sites inside that state first obtain a so-called general contractor licence. This general contractor licence is not only needed at the time of the actual execution of the respective works, but even at the time when a respective contract is concluded. The licence is granted by a body which convenes only four times per year. Similar requirements are found in many countries which traditionally regulate their economies in much detail. It is obvious that such rules and practices can delay the execution of an investment considerably. In addition, they also have a tendency to make the investment more expensive indirectly by reducing the number of competitors for a particular construction job.

While the last example fits well into the category related to timing and ease of implementation, one could also include it into another category comprising general business climate perceptions. The business climate of a country, province or community is composed of a number of elements including the legal framework, the political situation, and religion and other features characterizing a society. In this connection, the term legal framework refers less to private law and other rules directly relevant for the operation of an industrial activity, but rather to the general framework starting with the constitution of a country. Is the totality of legal rules friendly to private economic activities? In all industries, or are there different rules for specific branches such as energy, mining, steel, banking and insurances? What is the general attitude of the leading media towards a free market economy? Has free market economy a long tradition, or does the country have a socialist past or a tradition of state interference into the economy at least to some extent? What is the attitude of the various governments towards industrial investments in general and of the specific kind at the national, province, and local level? Is this attitude a stable one over decades, or is there a risk of swings between moods friendly and unfriendly to industrial investments? What is the attitude of the administration at the various levels? To what extent does the administration work independently from the political level? Is the rule of law guiding the administration? Is the law in reality close to the law in the books, or is there a major discrepancy between the two? Which role does corruption play at the political level, in the administration, in private companies, and in the court system? Is

there visible progress, no progress, or even a deterioration of the situation in these fields?[5] Apart from corruption, does the administration, from customs clearance over central banks and environmental authorities to the local police, work effectively and reliably? Do the courts fulfil their tasks fast, reliably and in a non-discriminatory way? The answers to these and similar questions can give a clear or a mixed picture. In countries with an uninterrupted democratic history over decades, legal, political, religious and other social elements will have a tendency to fit together and give a rather clear picture, including the justified expectation that the situation will continue, unless there are symptoms of social unrest to be expected. In other countries, like in particular a number of countries in which the abolition of communist regimes has been a true revolution or like a revolution, instability seems to be inherent, and it is difficult to predict the business climate for the time ahead.

If one would list selection criteria along a scale from very general, abstract ones relating to a country to very concrete, practical ones relating to a specific site, the business climate is rather close to the general end. At the other end, there are physical properties of the envisaged site and its surroundings: What does the surface of the site look like? Is it necessary to remove existing buildings, wood or other items? How is the underground? Does it contain pollution? Is it stable enough for the installation of buildings and machinery? Is there an existing utility infrastructure, or is public or private investment necessary to provide the respective installations? Will they be available on time?

Again more on the general end, quality of life in the region of the investment must not be neglected. If a considerable number of expatriates, ie experts from abroad are needed to build and operate the new factory, it makes quite a difference if it is easy to attract such people because the region is attractive for them and their families or not.

Last but not least, one should also look ahead. Does the site provide space for a future expansion? What is the expectation with respect to the mid-term and long term availability of local customers, suppliers, other business partners, and workforce? Also with respect to the state of the legal system, the expectation of its further development is at least as important as its present status.

III. Valuation of criteria

The list of selection criteria in part II is not exhaustive. Also, the order of sequence which followed the relevance attributed to them in one actual case of a major investment can vary considerably depending on the type of investment and other circumstances. Even more, the individual weight given to single factors or a combination of related factors depends very much on the circumstances. Among these circumstances, individual experiences of decision makers inside a company or of advisors involved play a considerable role. It is also by no means given at the outset which factors are quantified and which ones are only taken into account as soft factors. Readers of this chapter will easily detect soft factors which, in their mind, lend themselves to a valuation in money terms.

At the end of the day, site selection decisions, like all major investment decisions, are entrepreneurial decisions. To decide if and where new production capacities are invested is really at the core of entrepreneurship.

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[5] On the issue of corruption, see Hans Jürgen Gruss in chapter [X], *Caucasian experiences*, and Nagla Nassar in chapter [X] *Fighting corruption – Safeguards and enforcement*.

D. The role of law

Part C contains a number of references to the legal system and individual laws. However, the law as such, the economic law of a country, and individual fields of law are not listed as specific selection criteria.

This is not mere accident. Instead, it is the experience of the author that the relevance of economic law in a site selection process is very limited. Clearly, the indispensable prerequisites referred to under C I will be examined very early. The absence of such pre-conditions may lead to the deletion of a certain country in the first stage of a selection process. But details of the legal system will hardly have a major influence on a decision between two or more sites in countries which show more similarities than differences in their political and legal system. As for economic law, it can play a more or less important role depending on its definition. The author of this chapter does not use the definition of economic law developed by *Matteo Ortino* in Part 2 Chapter 1 or strictly rely on any other definition of the term. He uses the term as a general notion referring to all legal rules which are designed to regulate business. Amongst these those legal fields which have the clearest measurable effects on the cost of production and exportation will be considered the most important ones by an investor.

Not surprisingly, tax laws play an eminent role. Their effects can be expressed in money terms most easily. Not all, but many taxes are relevant: Corporate and individual income taxes, property taxes, sales and other indirect taxes as well as concises and other fees related to investments and production activities. Besides tax rates, rules like depreciation rules and the complexity of the tax system as such will be taken into account.

A close relative of tax law, tariffs, can also be of importance. In general, tariffs have lost much weight over the last decades due to multilateral agreements within the frameworks of GATT and WTO, regional free-trade zones and bilateral agreements.[6] Nevertheless, import as well as export tariffs can still be of relevance. Also, customs proceedings can impede both the erection of a plant and its operation, in particular if they are influenced by a lack of capacities or corruption. Non-tariff trade barriers come on top.[7]

For an industrial investor, environmental laws are often very relevant. Again, it is not the substantive law alone. Most multinational groups from Europe, at least, apply the high standards prescribed in their home countries also in their other plants worldwide. The adaptation of such standards to the specific requirements of a given jurisdiction can nevertheless be very costly. In addition, the procedural rules and practise can provide hurdles and pitfalls. The scheduling of major industrial investments is often influenced to quite some extent by the duration of permitting proceedings and the uncertainties related thereto.

In a certain, but limited correlation with the importance of the personnel costs, labour law can influence the selection decision. Again, both the law in the books and the law in action have to be looked at. The latter is particularly important in the field of collective labour law. The legal rights, the organizational strength and the actual behaviour of trade unions do not only influence the cost of production, but also the steadiness of operations. This is very relevant, if a factory is part of an international supply chain.

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6 A trend which will possibly not continue, see Richard Septi in chapter [X], *The Trade Policy Perspective*.

7 Ibid.

Individual labour law, especially the rules regarding protections against dismissals, can have a palpable negative effect on the flexibility of a company.

By contrast, the social security laws can more easily be taken into account as a calculation factor. A comparison between continental European social security systems and the US shows that, at least at the long end, the obligation for employers to contribute to state run social security systems is not necessarily negative for a company. The American system of company run retirement and medical aid plans can mean both a heavy burden on the balance sheet and additional administrative costs plus an add-on to the role and importance of trade unions.

The foregoing areas cover fields of law with more or less calculable effects on the cost of investment or the cost of production. Therefore, they find their way into a selection assessment rather easily. Other legal rules and their practical application may play a role in the assessment of the overall business climate as referred to above under C II 3. On the other hand, many fields of law which dominate the legal education in most countries and which are in the focus of private citizens and, to some extent, also in that of the business community are not of much interest for an industrial investor in a site selection process. This is true for contract law and many other fields of private law (with the exception, to some extent, of property law), for company law (provided that there is a company law framework which allows private entities to create companies and to dispose of their participations in them), unfair competition law, private international law, criminal law, and, partly, administrative law. Civil procedure rules would normally only have a very limited relevance as a major element influencing the effectiveness of the judiciary system. However, in the case of the US, the heavy burden imposed on defendants by discovery, contingency fees and other particuliarities draws some attention on a field of law which one would normally not consider as being part of economic law. The effect of these particuliarities of the US law is not only felt once law suits against the company have actually started. Instead, groups of companies often undertake major endeavours to safeguard the corporate separateness between their US subsidiaries and the non-US parent companies. These measures make the management of US subsidiaries and the integration into a multinational group more complicated as is the case for subsidiaries in other countries.

Competition law, ie the rules relating to cartels, dominant market positions and merger control, can obviously influence business activities quite severely. However, they are not looked at when making a decision between competing sites (unless the investment takes place as an acquisition of an existing entity which, of course, can be heavily influenced by merger control rules), even more so since practically all countries do have competition laws which mostly follow the same basic concepts.

To some extent in accordance with incentives granted for the investment by governments, the applicability of state aid law will have to be examined. This is true, in particular, in the case of investments in member countries of the European Union which can be subject to attacks by the European Commission, be it on her own initiative or resulting from complaints by competitors. Even if no state aid law is applicable to the jurisdiction where the investment takes place, state aid granted can have severe legal consequences in the form of countervailing duty proceedings opened by governments or the European Union. As in the case of tariffs, countervailing duty law is a field in which not only the jurisdiction of the selected site must be taken into account, but all jurisdictions into which goods produced at the site are intended to be imported.

Some countries have specific legal rules resulting from their history or other special circumstances which have no equivalent in other countries. An example for this category is the Broad-Based Black Economic Empowerment Act, 2003, in South Africa which leads to certain restrictions relevant for investors planning to create and operate a company in South Africa. Such requirements usually reduce the attractiveness of a jurisdiction in a site selection process.

Again, a closer look at the fields mentioned in the previous paragraphs shows that some of the fields of law dealt with therein will be much more relevant for producers of consumer goods or financial institutions. In the case of the latter ones, the statutes and other rules regulating these specific industries, like banking and insurances will appear very early in the ranking of all factors, maybe even before many of the cost-related criteria.

All in all, economic law and other areas of law have a certain role in the assessment of the suitability of a country, region or community for an industrial investment. However, within the world of more or less industrialized countries this role is limited.

Chapter 3
Securities Law

The Competition of Systems in the Market for Listings

Arthur B. Laby[*] *& John Broussard*[**]

A. Introduction

Before the ink was dry on the Sarbanes-Oxley Act of 2002, American academics and policy-makers were assessing the effects of the new legislation on the competitiveness of the U.S. markets. In one camp are those who argue that the law is a short-sighted response to a short-lived crisis, driving non-U.S. issuers from the U.S. markets and hampering the competitiveness of the markets. In the other camp are those who maintain that the legislation was long overdue and will enhance competitiveness by attracting to the United States firms that are eager to demonstrate their ability to comply with robust regulatory norms. This paper discusses the debate and presents preliminary empirical data from four countries bearing on why a non-U.S. company that decided to register and sell shares in the United States would deregister and exit the U.S. markets. The initial results suggest strongly that deregistering firms are leaving not necessarily because of regulatory costs, but due to lackluster performance compared to their peers. This conclusion should be important to policy-makers and warrants further study.

Sarbanes-Oxley was a watershed. Ever since the enactment of the federal securities laws in the 1930s, the U.S. Congress and the Securities and Exchange Commission ("SEC") steered clear of regulating the governance of corporations registered with the SEC and listed on the major exchanges. Although exceptions exist, disclosure, not regulation, has been the essential ingredient of the U.S. federal securities laws.[1] Governance of most companies was left primarily to state legislatures and state courts.

Sarbanes-Oxley changed the landscape. The Sarbanes-Oxley Act was a reaction to the corporate debacles of 2001 and 2002 and Congress designed the law to correct systemic weaknesses in corporate governance. For the first time, Congress reached into the structure of public companies to require officers, directors, and others to pay attention to matters previously left to the province of state regulation. The statute required top officers to certify the integrity of the company's financial statements,[2] prohibited a company from making certain loans to its officers and directors,[3] required management to report on the company's internal controls,[4] enhanced the independence of the company's audit committee,[5] and directed the SEC to adopt rules requiring companies to implement a

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1 J. Seligman, *The Transformation of Wall Street* (3rd ed. Aspen, New York, 2003) 38.

2 Sarbanes-Oxley Act of 2002 s 302, 15 USC s 7241 (2006).

3 Ibid s 402, 15 USC s 78m.

4 Ibid s 404, 15 USC s 7262.

5 Ibid ss 201a, 202-04, 15 USC s 78j-1.

code of ethics.[6] The Act also established new standards for auditor independence and created the Public Company Accounting Oversight Board ("PCAOB") to regulate, oversee, inspect, and discipline audit firms.[7] It even required new rules to regulate the conduct of lawyers practicing before the SEC.[8] And this is only a partial list.

Shortly after its passage, commentators began calling the new legislation the most significant change to U.S. corporate governance since the Great Depression. Although the U.S. federal securities laws have been amended over the years, the changes wrought by Sarbanes-Oxley were seen as the most significant since the original laws were drafted.[9] It was not long, therefore, before the plangent cries of the critics began.

Opponents of the new law echoed opponents of the newly born Securities Act of 1933 seventy years earlier. Those objecting to the 1933 Act argued in August of that year that the new law would hamper the competitiveness of the U.S. markets by forcing corporations to go offshore for capital.[10] Similarly, critics of Sarbanes-Oxley maintained that the Act would cause companies considering initial public offerings ("IPOs") in the United States to opt for London or Hong Kong instead. They also stated that Sarbanes-Oxley would encourage non-U.S. companies already cross-listed in the United States to delist and deregister to avoid new costs imposed by the statute.[11] Thus began an active debate in the popular and academic press on the topic of overregulation and whether Congress and the SEC had gone too far, threatening the viability and competitiveness of the U.S. markets.

Several years have now passed since the enactment of Sarbanes-Oxley. After an initial flurry of SEC rulemaking to meet the deadlines imposed by Congress, the SEC has had an opportunity review whether it might ease the implementation of certain provisions of the Act, such as section 404, which requires reporting on internal controls. Over the past two years, in response to charges that U.S. regulators overreacted to the corporate failures of 2001 and 2002, the SEC has issued a number of deregulatory measures to reduce the costs of complying with the legislation.[12] In June 2007, for example, the SEC adopted an interpretive release to provide guidance regarding management's evaluation and assessment of internal controls over financial reporting, which permitted

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6 Ibid s 406, 15 USC s 7264.

7 Ibid s 101, 15 USC s 7211.

8 Ibid s 307, 15 USC s 7245.

9 See H. Grubel, *Regulators vs. Adam Smith,* Wall Street Journal (New York 3 October 2002) A14.

10 Seligman (n. 1) 77.

11 Joyce E. Cutler, *PCAOB Member Disputes Reports Sarbanes-Oxley Has Hurt U.S. Markets* (2007) 39 Securities Regulation & Law Report 926; R. Clow, *Groups may delist to avoid tougher SEC rules,* Financial Times (London 24 October 2002) 2002 WLNR 6767325; John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement* (2007) 156 University of Pennsylvania Law Review 229; Steven M. Davidoff, *Regulating Listings in a Global Market* (2007) 86 North Carolina Law Review 89; Larry E. Ribstein, *Cross-listing and Regulatory Competition* (2005) 1 Review of Law & Economics 97, 127.

12 S. Labaton, *S.E.C. Eases Regulations on Business,* The New York Times (New York 14 December 2006).

a risk-based evaluation of internal controls.[13] In July 2007, the SEC approved PCAOB proposed Audit Standard No. 5 to eliminate what the SEC called the "unduly expensive and inefficient" requirements of Auditing Standard No. 2.[14]

In addition, after initial speculation about how the Act might affect competitiveness, academic researchers have concluded a number of empirical studies shedding light on the actual effects of the new law. Although researchers continue to disagree, the debate is becoming more informed than in the period shortly after Sarbanes-Oxley was passed. This paper adds to the growing literature on market competitiveness, presenting new data to help analyze whether overregulation is compromising competitiveness. We are particularly interested in non-U.S. companies that registered with the SEC before Sarbanes-Oxley and then decided to deregister from the SEC after passage of the Act. Why do the benefits of SEC registration no longer justify the costs?

To begin to answer that question, we examine the financial profiles of the deregistering firms compared to the stay-registered firms. Our preliminary results indicate that deregistering companies were poorly performing companies compared to those companies that remained registered. This was the case in each of the four countries that were part of our initial survey: Great Britain, France, Germany, and Italy. The results differed for each country, but the overall trend was similar.

These results are consistent with several explanations, and the policy implications differ depending on the explanation. These results, for example, could suggest that regulatory requirements are not the impetus for firms to deregister. Rather firms deregister when, due to poor performance, they no longer attract investment from the host country. The results, however, also could suggest that additional regulatory requirements cause companies to deregister and the added costs have greater negative effects on poorly performing companies than on more profitable firms. Perhaps the additional regulatory costs imposed by Sarbanes-Oxley were significant enough to push poorly performing companies over the brink and cause them to deregister. In this paper, we present the initial results of our study but forbear from making policy recommendations.

This paper proceeds as follows: Part B provides background with respect to non-U.S. firms that register with the SEC and cross-list on a U.S. exchange. Part C discusses reasons foreign companies would choose to cross-list. Part D addresses the extraterritorial application of the Sarbanes-Oxley legislation. Part E discusses the effects of the new law on market competitiveness. Part F is a brief literature review. Part G provides the methodology of our own empirical research and preliminary results. Part H concludes.

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[13] A Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934, Securities Act Release No 8,810, Exchange Act Release No 55,929, 72 Fed Reg 35,323 (27 June 2007).

[14] See Press Release, Securities and Exchange Commission, SEC Approves PCAOB Auditing Standard No. 5 Regarding Audits of Internal Control Over Financial Reporting; Adopts Definition of "Significant Deficiency'" (25 July 2007) http://www.sec.gov/news/press/2007/2007-144.htm accessed 30 March 2008; see also Public Company Accounting Oversight Board, Order Approving Proposed Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements, a Related Independence Rule, and Conforming Amendments, Exchange Act Release No 56,142, 2007 WL 2577384 (27 July 2007) http://www.sec.gov/rules/pcaob/2007/34-56152.pdf accessed 30 March 2008.

B. SEC Registration and Cross-Listing

Non-U.S. companies that access the U.S. markets are called foreign private issuers ("FPIs") by the SEC – as distinguished from governmental issuers – and we adopt that convention in the remainder of this paper. Most FPIs access the U.S. markets by selling American Depository Receipts ("ADRs") to U.S. investors. ADRs are instruments created by depository banks. They are negotiable U.S. securities that represent a claim on the FPI's publicly traded equity.[15] Most investors prefer ADRs to buying shares directly to mitigate the risk of currency fluctuations and the opacity of certain foreign regulations.[16]

FPIs can sell ADRs in the United States on four levels. Level 1 ADRs are sold over-the-counter without a listing on an exchange, and Level 1 ADRs are subject to an issuer exemption from registration and minimal regulation.[17] Level 2 ADRs are registered under section 12 of the Securities Exchange Act of 1934. They are generally listed on an exchange and a company selling Level 2 ADRs must comply with most registration and reporting requirements of the relevant exchange and the SEC. Level 3 ADRs, like Level 2, are listed and traded on a U.S. exchange, and the selling company is subject to exchange and SEC rules. FPIs typically sell Level 3 ADRs when making a public offering in the United States and, as a result, Level 3 ADRs are subject to the Securities Act of 1933 as well as the registration and reporting requirements of the Exchange Act. Finally, Level 4 ADRs are for securities with limited trading and they are not subject to significant regulation. Sarbanes-Oxley applies to Level 2 and Level 3 ADRs.[18]

The four levels of ADR trading give FPIs significant choice in accessing the U.S. markets. They also allow a FPI to change from one level to another, thereby lowering the regulatory burdens that might apply while, at the same time, maintaining some presence in the U.S. markets. Recently, when several FPIs announced plans to deregister, they did not exit the U.S. markets completely. Instead, they converted their ADRs from Level 2 or Level 3 to Level 1 and the ADRs continued to trade over-the-counter. SEC registration requirements, however, will no longer be applicable. Examples include U.K. companies, Imperial Chemical Industries, PLC and Spirent Communications, PLC.

A few foreign firms sell company shares – known as Global Shares – directly to U.S. investors. Global Shares trade in the United States the same way they trade in the firm's home country – the same security is traded in two markets. According to the SEC, Global Shares can have some advantages over ADRs because a FPI selling Global Shares in the United States does not depend on a depository bank for services. Investors can be better

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15 Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 12(g) and Duty to File Reports Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934, Exchange Act Release No 55,540, International Series Release No 1,301, 72 Fed Reg 16,934, 16,935 n 21 (5 April 2007).

16 L. Little, *ADR Trades Jumped to a Record in 2006,* Wall Street Journal (New York 16 January 2007) C3.

17 See 17 CFR s 240.12g3-2(b) (2007).

18 See Kate Litvak, *Sarbanes-Oxley and the Cross-Listing Premium* (2007) 105 Michigan Law Review 1857, 1865; Geoffrey Peter Smith, *A Look at the Impact of Sarbanes-Oxley on Cross-Listed Firms*, 5 (2007) http://ssrn.com/abstract=931051 accessed 30 March 2008; *Ribstein* (n. 11) 105.

served because Global Shares purchased outside the United States do not have to be converted to ADRs before sold on a U.S. exchange.[19]

C. Reasons to Cross-List

Non-U.S. companies presumably register with the SEC and list their shares in the United States because they believe the benefits of doing so outweigh the costs. In some cases, benefits are readily quantifiable, such as a cross-listing premium in valuation. In other cases, benefits are less quantifiable, or only quantifiable in the long term, such as enhanced profile or visibility in the host country. Researchers have put forth several rationales for cross-listing, which generally fall under either a liquidity thesis or a bonding thesis.[20]

According to the liquidity thesis, firms list on a foreign exchange for greater liquidity for their shares and easier access to capital. In the case of the United States, a cross-listing could enhance liquidity because U.S. markets are often considered deeper and more liquid than a company's home market. Cross-listing also might provide liquidity because U.S. investors face transaction costs when investing in foreign securities. A U.S. broker-dealer, for example, might be required to use a correspondent foreign broker-dealer to purchase non-U.S. shares. A U.S. investor also might face costs resulting from currency, regulatory, and clearing and settlement risks. These costs would be ameliorated if shares were offered in the United States and, therefore, a U.S. listing could result in increased demand.[21]

According to the bonding thesis, managers bond themselves by subjecting the company and themselves to tougher regulations, including robust disclosure, private liability, and governmental enforcement.[22] Just like a company can play a role in deciding which laws will apply to it by deciding where to incorporate and establish a place of business, so too can a company decide which regulatory system will govern its capital-raising and share trading. By choosing to cross-list in a foreign market, a company can *opt in* to a particular regulatory regime that might be more onerous than that of its home country (even if the firm cannot *opt out* of regulations at home).[23]

The bonding thesis assumes investors in a foreign firm may discount the share price to compensate for the risk that self-dealing or other value-impairing activity will occur. According to the bonding thesis, a cross-listing is meant to convince investors that the firm has decided to forgo private benefits of self-dealing in exchange for reducing the

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19 Additional Form F-6 Eligibility Requirement Related to the Listed Status of Deposited Securities Underlying American Depositary Receipts, Securities Act Release No 8,287, Exchange Act Release No 48,482, International Series Release No 1,273, 81 SEC Docket 28 (11 September 2003).

20 See Litvak (n. 18) 1861; *Coffee* (n. 11) 284; Craig Doidge et al, *Why Are Foreign Firms Listed in the U.S. Worth More?* (2004) 71 Journal of Financial Economics 205, 207-10; *Ribstein* (n. 11) 104.

21 Doidge et al (n. 20) 208.

22 Coffee (n. 11) 285; John C. Coffee, Jr, *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications* (1999) 93 Northwestern University Law Review 641, 691-92; Doidge et al (n. 20) 208-09.

23 See Ribstein (n. 11) 98-99.

discount investors might otherwise apply. This is known as bonding because the managers' *bond* is the risk of monetary penalties or other sanctions that might be imposed in the event of non-compliance with the more stringent rules of the host country.[24] After reviewing relevant data, Larry Ribstein recently concluded that bonding is the primary explanation for cross-listing.[25]

Liquidity and bonding hypotheses are not mutually exclusive, and they are consistent with other evidence suggesting that a third reason to cross-list is to signal to investors that the firm wishes to conduct a successful public offering of debt or equity.[26] By cross-listing, the firm signals its high quality and strong future prospects.[27] Several academic studies have borne out the bonding and signaling hypotheses. Cross-listing companies, for example, tend to come from countries where investor protection is weakest.[28] This observation might appear counter-intuitive because FPIs from weakly regulated countries would have to spend more resources to raise their standards high enough to cross-list. It is precisely those companies, however, which have the most to gain from cross-listing and most need to signal to investors that they are of higher quality than other companies from their jurisdiction.

Anecdotal evidence of bonding and signaling comes from statements made by delisting firms. When some companies deregister from the SEC, they make a point to emphasize that although they will no longer be required to meet the regulatory requirements of the U.S. Securities Exchange Act, they will remain subject to high regulatory standards in their home country. When Naspers Limited, a South African company, delisted from NASDAQ, it stated that it would still be subject to the JSE's listing standards, South Africa's corporate governance guidelines, and South African law. When Telenor ASA, a Norwegian telecommunications firm, delisted from NASDAQ, it explained that all of its investors would obtain the protections afforded by the Oslo Stock Exchange and Norwegian law.[29] These and other companies that choose to delist want to signal their continued high quality to investors, notwithstanding their decision to end compliance with Sarbanes-Oxley.

D. Extraterritorial Application of U.S. Law

Consistent with the bonding thesis, when FPIs register with the SEC and sell shares or Level 2 or 3 ADRs to U.S. investors, they generally subject themselves to the full panoply of the U.S. federal securities laws. This parity of treatment for non-U.S. firms contrasts with less stringent treatment other countries accord to foreign issuers. In many coun-

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24 Ibid 104-05.

25 Ibid 112.

26 William A. Reese Jr. & Michael S. Weisbach, *Protection of Minority Shareholder Interests, Cross-Listings in the United States, and Subsequent Equity Offerings* (2002) 66 Journal of Financial Economics 65, 86, 101-02.

27 Ribstein (n. 11) 109.

28 Ibid 106 (quoting Reese & Weisbach (n. 26)).

29 See Dominic Jones, *Foreign Firms Check Out of SEC's "Hotel California"* (Investor Relations Web Report 30 May 2007) http://www.irwebreport.com/daily/2007/05/30/foreign-firms-check-out-of-secs-hotel-california, accessed 30 March 2008.

tries, listing requirements for foreign issuers are less burdensome than those applied to domestic firms.[30] The SEC has made some exceptions for foreigners, but not many. FPIs, for example, are not required to file quarterly reports with the SEC.[31] Until recently they were not required to file on the SEC's EDGAR system.[32] And FPIs can file their financial statements with the SEC using International Financial Reporting Standards developed by the International Accounting Standards Board, as opposed to adhering to US GAAP.[33] Most other provisions of the securities laws, however, apply equally to FPIs.

When Sarbanes-Oxley was passed, and Congress provided no general exception or exclusion for FPIs, the FPI community reacted negatively. In letters to the SEC commenting on proposed rules to implement Sarbanes-Oxley, foreign governments and representatives of foreign firms objected to the extraterritorial application of the law. Japanese authorities, for example, raised "serious concerns" with respect to the application of the law to Japanese firms and urged that the problems addressed by Sarbanes-Oxley be handled by cooperation between the United States and foreign authorities.[34] The British argued that the SEC should adhere to its policy of deferring to foreign laws with respect to corporate law and corporate governance, given the overlap between local laws and Sarbanes-Oxley.[35] The Swiss argued more strenuously that application of Sarbanes-Oxley would be inconsistent with foreign law and conflict or unduly interfere with the internal operations and obligations of foreign private issuers.[36]

When the SEC believed that application of rules adopted under Sarbanes-Oxley would directly conflict with a FPI's home country's law, it provided regulatory relief to avoid the conflict. One example is the rule adopted under section 307 of the Act, which required the SEC to prescribe minimum standards for attorneys appearing and practicing before it. The rule requires an attorney to report evidence of certain violations of law "up-the-ladder" within the company to the chief legal officer, chief executive officer, or an equivalent officer, and, if they do not respond, to the audit committee or the full board. Many non-U.S. attorneys complained that reporting under this requirement would be

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30 See Coffee (n. 11) 239 n 20.

31 See Exchange Act Rule 13a-13, 17 CFR s 240.13a-13 (2007).

32 Mandated Edgar Filing for Foreign Issuers, Securities Act Release No 8,099, Exchange Act Release No 45,922, International Series Release No 1,259, 67 Fed Reg 36,678 (14 May 2002).

33 Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP, Securities Act Release No 8,879, Exchange Act Release No 57,026, International Series Release No 1,306, 73 Fed Reg 986 (4 January 2008).

34 Letter from Hideo Hato, Director for Corporate Accounting and Disclosure, Japanese Financial Services Agency (SEC Comment letter 19 August 2002) http://www.sec.gov/rules/proposed/s72102/hhato1.htm, accessed 30 March 2008.

35 Letter from Peter Maynard, Group Legal Services Director, Prudential PLC (SEC Comment letter 19 August 2002) http://www.sec.gov/rules/proposed/s72102/pmaynard1.htm, accessed 30 March 2008.

36 Letter from Arnold Knechtle, Director, and Christian Stiefel, Legal Counsel, Federation of Swiss Industrial Holding Companies (SEC Comment letter 19 August 2002) http://www.sec.gov/rules/proposed/s72102/aknechtle1.htm, accessed 30 March 2008.

inconsistent with their home country law.[37] Thus, in the final rule, the SEC stated that a non-U.S. attorney "shall not be required to comply … to the extent that such compliance is prohibited by applicable foreign law."[38]

This specialized treatment, however, was not the norm. Although some consideration was given to exempting foreigners from provisions of Sarbanes-Oxley, those efforts largely failed and FPIs must satisfy almost all provisions of the statute. FPIs registered with the SEC, for example, are subject to the same section 302 certification requirements and the section 404 annual assessment of internal control requirements as other issuers. The only difference is that since FPIs do not file quarterly reports, the evaluation must only be done at the end of each fiscal year.[39] FPIs were required to comply with the section 404 assessments with the first report filed for the first fiscal year ending on or after July 16, 2006.

FPIs were particularly concerned about the application of Sarbanes-Oxley because they felt trapped in a system from which they could not escape. Until recently, although it was relatively simple for a FPI to access the U.S. markets, it was often almost impossible to leave. SEC Chairman Cox referenced the 1970s Eagles song "Hotel California," agreeing that foreign firms often could "never leave" even if they wanted to. Cox said that this was a great song, but a bad business model.[40] As a result, the FPI community viewed the application of Sarbanes-Oxley to non-U.S. firms as unfair. If a FPI had registered with the SEC before the passage of Sarbanes-Oxley, that decision presumably was based on a cost-benefit determination shorn of the burdens imposed by the Act. Since a decision to register could not be easily reversed, the inability to leave exacerbated the frustration of foreign firms that had to comply.

In March 2007, the SEC adopted revised rules to remove barriers to deregistration and delisting. Under the old rules, to deregister and delist, a FPI would have to show it had a low number of U.S. shareholders, or a decrease in the amount of its U.S. public float. Under the new rules, a FPI may terminate its SEC registration under section 12(g), or its reporting obligations regarding a class of equity or debt securities under section 15(d), rather than just suspending those obligations, based on low trading volume.[41] Although under the new rules FPIs will not be wedded to the U.S. markets if they want to exit, those rules do not address underlying concerns that the Act has made the U.S. markets substantially less competitive.

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37 See, eg, Letter from Tohru Motobayashi, President, Japan Federation of Bar Associations (SEC Comment letter 31 March 2003) http://www.sec.gov/rules/proposed/s74502/tmotobayashi1.htm, accessed 30 March 2008.

38 17 CFR s 205.6(d).

39 17 CFR s 240.13a-15(b)(1); 17 CFR s 240.15d-15(b)(1).

40 Christopher Cox, SEC Chairman, *Opening Remarks at Open Meeting* (Speech at a meeting of the Securities and Exchange Commission 14 December 2005) http://www.sec.gov/news/speech/spch121405cc.htm, accessed 30 March 2008.

41 Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 12(g) and Duty to File Reports Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934, Exchange Act Release No 55,540, International Series Release No 1,301, 72 Fed Reg 16,934 (5 April 2007).

E. Competitiveness of the U.S. Markets

The debate over the effects of Sarbanes-Oxley on markets has become as important as the debate over the effects of the Act on issuers. The Committee on Capital Markets Regulation Interim Report from November 2006, known as the Paulson Committee Report, noted that U.S. capital markets lost competitiveness to foreign markets and that regulatory and legal costs played a role.[42] Shortly after the release of the Paulson Committee Report, New York Mayor *Michael Bloomberg* and Senator *Charles Schumer* issued a report stating that New York's decline in competitiveness was attributable in part to concerns about compliance with section 404.[43] Even President *Bush* in his State of the Economy address in January 2007 noted that "complying with certain aspects of [Sarbanes-Oxley], such as Section 404, has been costly for businesses and may be discouraging companies from listing on our stock exchanges."[44] Similarly, many in the academic community have asserted that Sarbanes-Oxley has damaged the competitiveness of the U.S. markets.[45]

I. Concerns About Market Competitiveness

Concerns about market competitiveness include three potential developments. First, issuers both in the United States and outside the United States contemplating a public offering may choose London or Hong Kong over New York. Second, SEC registered and cross-listed firms may decide to give up their U.S. listing and exit the U.S. markets. Finally, concerns have been raised that the advantages to a U.S. listing – such as the premium FPIs enjoy as a result of cross-listing – will evaporate, which may fuel the first two concerns mentioned. We look at each of these concerns in turn.

The Paulson Committee Report emphasized the shift in attention away from U.S. markets to foreign markets and placed blame, at least in part, on overregulation. The Report contains figures on the increasing number of overseas IPOs and pointed out that London has begun to attract a greater share of IPOs from U.S. companies.[46] The Bloomberg-Schumer report noted that in 2006, U.S. exchanges attracted only one-third of the IPOs (by market value) that they attracted in 2001.[47] Even SEC Chairman Cox, in a 2007 interview, admitted that Sarbanes-Oxley caused many in the United States

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42 Committee on Capital Markets Regulation, *Interim Report of the Committee on Capital Markets Regulation* (Report) (2006) 47.

43 Michael Bloomberg and Charles Schumer, *Sustaining New York's and the US' Global Financial Services Leadership* (Report) (New York 2007) 12 http://www.senate.gov/~schumer/Schumer-Website/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf, accessed 29 March 2008.

44 George Bush, *State of the Economy Report* (Speech at New York's Federal Hall January 2007) http://www.whitehouse.gov/news/releases/2007/01/20070131-1.html, accessed 29 March 2008.

45 See Davidoff (n. 11) 91; Robert DeLaMater, *Recent Trends in SEC Regulation of Foreign Issuers: How the U.S. Regulatory Regime is Affecting the United States – Historic Position as the World's Principal Capital Market* (2006) 39 Cornell International Law Journal 109, 116.

46 *Committee on Capital Markets Regulation* (n. 42) 2-3.

47 Bloomberg and Schumer (n. 43) 12.

to look at opportunities on foreign markets.[48] Some evidence allegedly showed that the number of non-U.S. companies listing in the United States compared to U.S. companies listing declined after 2002.[49] And anecdotal evidence from issuers suggests they are looking at overseas markets as a way to avoid U.S. regulation.[50]

The potential shift to foreign markets is welcome news to foreign exchanges, which often promote a lower level of regulation abroad as a reason to list there. An official from the Toronto Stock Exchange stated that U.S. firms should look to the TSX as a potential market because it is more lightly regulated than the U.S. exchanges.[51]

In addition to the focus on whether U.S. and non-U.S. firms are deciding to list abroad as opposed to in the United States, some have focused attention on deregistrations and delistings. The number of FPIs that decided to deregister and delist allegedly began to increase around 2002, and the number of FPIs delisting increased relative to the number of U.S. companies delisting. Some concluded, therefore, that Sarbanes-Oxley caused the decision of FPIs to delist.[52] Anecdotal reports from companies choosing to delist suggest that Sarbanes-Oxley is the culprit. Telekom Austria AG and Vernalis PLC, a British pharmaceutical company, referenced Sarbanes-Oxley as a reason for delisting.[53] More recently, U.K.-based BioProgress PLC, Norway-based Petroleum Geo-Services ASA, and the Israeli company Koor Industries Limited, all cited the high costs of complying with the Exchange Act as a reason to delist and deregister.[54]

II. Responses to Concerns About Competitiveness

Others take a different view and, over the last several years, a pro-regulatory response has emerged. In a presentation shortly before he left the Commission, former SEC Commissioner *Roel Campos* stated that he believes regulation is a competitive *advantage* for the U.S. markets. Commissioner *Campos* explained that the U.S. share of IPOs declined before 2002 and then increased in 2005, and much of the decline in foreign listings in 2005 (15 of 26) was due to mergers and acquisitions. Sarbanes-Oxley, therefore, cannot be blamed.[55] PCAOB member *Charles Niemeier* similarly disputed statements in the Paulson Committee Report and the Bloomberg-Schumer report stating that research in the area of market competitiveness does not support findings that regulation is hurting

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48 Headliner Q&A, *Getting it Right* (2007) 3 Journal of Accountancy 28, 29.

49 Hong Zhu and Ken Small, *Has Sarbanes-Oxley Led to a Chilling in the U.S. Cross-Listing Market?* (March 2007) CPA Journal http://www.nysscpa.org/cpajournal/2007/307/essentials/p32.htm, accessed 29 March 2008.

50 M. Richtel, *Looking for Best Place to Take a Company Public, Some Look Overseas,* The New York Times (New York 22 December 2006) C5.

51 Rachel McTague, *At ABA Meeting, TSX, UK Lawyer Solicit Foreign Stock Exchange Listings* (2007) 39 Securities Regulation & Law Report 1275.

52 Zhu and Small (n. 49).

53 P. Stiff and R. Stone, *British Airways Approves Delisting From NYSE as More European Firms Tire of U.S. Rules*, Wall Street Journal (New York 26 April 2007) C3.

54 Jones (n. 29).

55 Roel Campos, *Speech by SEC Commissioner: Remarks Before the Consumer Federation of America Financial Services Conference Speech to CFA* (Speech December 2006) http://www.sec.gov/news/speech/2006/spch120106rcc.htm, accessed 29 March 2008.

competition. Rather, enhanced regulation, such as Sarbanes-Oxley, is attractive because of investor protections afforded by the new law and a consistent premium for issuers subject to it.[56]

More recently, former Senator *Paul Sarbanes*, a primary sponsor of the Sarbanes-Oxley Act, told a Rutgers University audience that regulation of the Sarbanes-Oxley variety is a competitive advantage.[57] French economic minister, *Christine Lagarde*, agrees, stating that the "security and solidity" of the French regulatory system was a strength for competitiveness and that any reforms should be in the area of taxation.[58]

Recent research suggests that these individuals may be right. According to the pro-regulatory view, enhanced regulation and enforcement activity yield higher valuation of securities and a lower cost of capital. As discussed, managers agree not to appropriate private benefits by subjecting themselves to stringent regulation, such as SEC enforcement and private investor lawsuits. As a result, the market responds favorably to such firms compared to those where managers do not agree to forgo such benefits.[59] The Federal Reserve Bank of New York released a report earlier this year concluding that at least with respect to the U.S. equity markets, U.S. competitiveness has not suffered.[60] Moreover, the market share of non-U.S. companies listing on U.S. exchanges as opposed to the London Stock Exchange has increased from 1998 to 2005.[61]

In addition to information regarding the number of listings or delistings, others have studied the share price premium obtained by FPIs who choose a U.S. listing. By examining a ratio known as Tobin's q, which compares the market value of a company's stock to the book value, researchers have observed that FPIs with shares cross-listed in the United States enjoy a significant premium compared to non-U.S. issuers from the same country, which do not cross-list.[62] *Kate Litvak*, however, has found that the premium for FPIs cross-listed in the United States and subject to Sarbanes-Oxley has declined relative to the premium for FPIs who have accessed the U.S. markets but are not subject to the new law.[63]

Supporters of Sarbanes-Oxley point out that establishing a cross-listing in the United States still results in a premium, whereas cross-listing in the U.K. results in none.[64] They also point out that the drop in the number of U.S listings and the decline in valuations occurred before the advent of Sarbanes-Oxley. SEC Chairman *Cox* made this point to the U.S. Chamber of Commerce in a conference on competitiveness in early 2007. He

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56 Cutler (n. 11).

57 P. Sarbanes, *Regulating Business in the 21st Century: The Case of Sarbanes-Oxley* (Speech April 2008).

58 B. Hall, *Paris Covets First-Tier Status*, Financial Times (London 5 October 2007) 3.

59 See Coffee (n. 11) 285.

60 Stavros Peristiani, Federal Reserve Bank of New York, *Evaluating the Relative Strength of the U.S. Capital Markets* (Report) (2007) 13 Current Issues on Economics and Finance http://www.newyorkfed.org/research/current_issues/ci13-6.html, accessed 4 April 2008.

61 Craig Doidge et al, *Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices over Time* (2007) 4 Charles A. Dice Center for Research in Financial Economics Working Paper No. 9/2007 http://ssrn.com/abstract=982193, accessed 29 March 2008 (Dice Center Working Paper 9/2007).

62 Doidge *et al* (n. 20) 205, 206.

63 Litvak (n. 18) 1860-61.

64 Doidge et al (n. 61).

noted that the decline in the U.S. market share for listings predates Sarbanes-Oxley and hypothesized that other factors caused the decline, such as the new opportunities for global listings.[65] According to one recent study, cross-listing premia actually declined in the period 2000-2001 before the passage of Sarbanes-Oxley, increased in 2003 and then stabilized.[66] Thus, researchers reviewing the empirical evidence are unable to draw firm conclusions as to what the data shows.[67]

John Coffee asks why any FPI would delist if a premium for cross-listing in the United States remains?[68] Perhaps the answer is that the overall costs of staying listed are not worth the benefits. Coffee puts forward the potential rationale that the benefits of a valuation premium might be overridden by other factors, such as the control regained by controlling shareholders, which they relinquished with a cross-listing; a desire to avoid the application of new regulation; or fear of potential U.S. enforcement penalties. Coffee hypothesizes that the United States might be a magnet for *higher quality* issuers that will take advantage of lower costs of capital. It is this possibility – that lower quality issuers are leaving the U.S. markets and higher quality issuers are remaining – that we address below. If Coffee is right, then, as he states, the policy implications are significant and regulators should avoid reducing regulation because a reduction would reduce the bonding premium foreign firms obtain by cross-listing their shares and increase their cost of capital.[69]

F. Literature review

Several studies have been performed over the past several years examining the effects of Sarbanes-Oxley on both U.S. issuers and FPIs. A number of studies focus exclusively on the effects of Sarbanes-Oxley on FPIs. Some researchers show that investors react negatively to Sarbanes-Oxley, calling into question benefits of cross-listing, such as the bonding premium discussed above. Other research tries to isolate the effects of Sarbanes-Oxley by doing a cross-regional analysis. Some researchers focus on listing and delisting decisions and certain research, similar to ours, examines which companies are more prone to deregistration and delisting and conclude that those firms with low turnover, poor performance, or other negative characteristics are more likely to give up their U.S. listing.

Kate Litvak sought to test the validity of investors' views that Sarbanes-Oxley would negatively affect FPIs cross-listed in the United States that were subject to the new law.[70] She found that FPIs subject to Sarbanes-Oxley displayed negative returns as a result of certain events, such as Congressional action indicating an increased probability that the law would be enacted and would apply to FPIs. Almost every important announcement suggesting increased likelihood that the law would be passed was associated with a

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65 Christopher Cox, *Speech by SEC Chairman: Remarks to the U.S. Chamber of Commerce's First Annual Capital Markets Summit: Securing America's Competitiveness* (Speech March 2007) http://www.sec.gov/news/speech/2007/spch031407cc.htm, accessed 4 May 2009.

66 Doidge et al (n. 61).

67 See Coffee (n. 11) 247 n 37.

68 Coffee (n. 11) 237.

69 Ibid 300.

70 Kate Litvak, *The Effect of the Sarbanes-Oxley Act on Non-US Companies Cross-Listed in the US* (2007) 13 Journal of Corporate Finance 195.

negative reaction to stock price in cross-listed companies compared with companies not cross-listed, and the one event suggesting a possible exemption for cross-listed companies was associated with a positive reaction.

Xi Li also examined the effect of Sarbanes-Oxley on cross-listed FPIs.[71] Li compared the returns of cross-listed FPIs during a number of Sarbanes-Oxley legislative events from 1999 to 2003 against an index of those companies' home markets (excluding any FPIs) over the same time period.[72] Li also discovered that the cross-listed FPIs with better corporate governance structures tended to respond more negatively to Sarbanes-Oxley regulation.[73] The study concluded that the costs of compliance with Sarbanes-Oxley for FPIs could significantly exceed the benefits and weaken existing benefits of legal bonding.[74]

Similarly, *Philip G. Berger, Feng Li,* and *M. H. Franco Wong* found that FPIs had a negative valuation reaction to Sarbanes-Oxley compared with U.S. firms.[75] The authors interpret the negative reaction to mean that the marginal benefits of bonding for cross-listed firms were lower than the marginal costs imposed by Sarbanes-Oxley. These researchers predict an inverse relation between the response to Sarbanes-Oxley and level of investor protection in a company's home country – and a positive relation between reaction to the law and a FPI's growth potential. The results were consistent with Sarbanes-Oxley being more beneficial to FPIs from countries where investor protections are weaker.

Christopher Woo performed a regional analysis. He conducted a survey of issuers from twelve jurisdictions to measure the effects of Sarbanes-Oxley on the quality of the companies from particular regions listing in the United States.[76] Examining data from the point of view of both trading volumes and market capitalization, *Woo* concludes that the U.S. markets are important to companies in Latin America and Israel and that any increased regulation will not result in a decrease in listings from those areas.[77] Woo notes, however, that issuers from Japan, Australia, and Europe, with more robust disclosure rules, may be more inclined not to list in the United States.[78]

Geoffrey Peter Smith also examined effects of Sarbanes-Oxley on cross-listed firms.[79] Smith reviewed the differential response between firms affected by Sarbanes-Oxley and OTC counterparts not affected by the statute. Smith also looked at new cross-listing and delisting activity surrounding Sarbanes-Oxley. Smith finds an overall negative response to new rules with respect to stock price. New cross-listings fell, but delistings were steady – although a greater percentage of delistings (37 % as opposed to 18 %) were voluntary.

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71 Xi Li, *The Sarbanes-Oxley Act and Cross Listed Foreign Private Issuers* (2007) (on file with author).

72 Ibid 1-2.

73 Ibid 29.

74 Ibid.

75 Philip Berger, Feng Li & M.H. Franco Wong, *The Impact of Sarbanes-Oxley on Cross-listed Companies* (2005) University of Chicago Working Paper (on file with author).

76 Christopher Woo, *The Effects of the Sarbanes-Oxley Act on Foreign Private Issuers* (2003) (on file with author).

77 Ibid 60.

78 Ibid.

79 Smith (n. 18).

Some studies have looked specifically at a firm's decision to list and delist. *Craig Doidge, G. Andrew Karolyi,* and *Rene M. Stulz* analyzed the argument that Sarbanes-Oxley has discouraged foreign listings due to the costs imposed.[80] The authors assert that this argument can only be supported if firms that would have listed in the United States in the 1990s would not do so now.[81] The authors found scant support for this proposition, and uncovered little evidence to show that listing decisions have changed in the aftermath of Sarbanes-Oxley.[82] Instead, the authors concluded that the only change is that non-listed firms tend to be smaller and therefore less likely to list on major exchanges.[83]

Jon Witmer examined why foreign companies decide to delist from U.S. exchanges.[84] Witmer observed the characteristics of firms that voluntarily delist – finding that smaller firms with a lower percentage of turnover in the United States are more likely to delist.[85] In addition, Witmer noted that firms are more likely to cross-delist if they are from countries with less investor protection or if they listed after Sarbanes-Oxley was passed.[86] Witmer acknowledged that these findings support the hypothesis that the added expense of U.S. regulation has led to increased delisting.[87]

Work by *Susan Chaplinsky* and *Latha Ramchand* is perhaps the most similar to ours, comparing delisted and stay-listed firms to isolate the characteristics of each.[88] The authors examined listings and delistings of non-U.S. firms over a 44 year period (1961-2004) to determine whether the stay-listed firms were of higher quality than the delisted firms. They found that those companies that voluntarily delisted had low profitability, median assets and market capitalization of less than $ 230 million, a declining share price by 54 % from listing to delisting, and 60 % had no analyst coverage within a year following its listing. The authors conclude that these companies suffered from poor quality and low investor recognition. They contend that regulatory costs alone cannot explain the delistings. Rather, the exit is better explained because the firms were not viable candidates for listing in the first place.

Our work differs from *Chaplinsky's* and *Ramchand's* in a few respects. First, their data ends in 2004, two years after the passage of Sarbanes-Oxley and before some of the rules implementing the statute were effective. Our data includes the years 2005 and 2006. Second, in addition to examining return on assets, we measured return on equity and profit margin as well, providing a different basis on which to assess the financial profile of the deregistering firms.

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80 Doidge et al (n. 61) 1.

81 Ibid 42.

82 Ibid.

83 Ibid.

84 Jon Witmer, *Why Do Firms Cross-(de)list? An Examination of the Determinants and Effects of Cross-delisting* (2005) 2 Queen's University Preliminary Draft (on file with author).

85 Ibid.

86 Ibid.

87 Ibid.

88 Susan Chaplinsky and Latha Ramchand, *From Listing to Delisting: Foreign Firms' Entry and Exit from the U.S.* (2007) (on file with author).

G. Methodology and Preliminary Results

This section explains our methodology and preliminary results. We reviewed the financial profile of deregistered and stay-registered firms from four countries over a seven year period. Although our results are preliminary, the data show a clear trend: deregistering firms have substantially weaker performance compared to those firms that stay registered. This data calls into question the widely held assumption that the costs of regulation alone are causing FPIs to deregister. If our results are replicated with additional study, it appears that poor performance, not necessarily regulatory costs, is driving certain FPIs from the U.S. markets.

To begin to understand why FPIs might want to delist and deregister, we first set out to understand the financial profile of those companies that actually deregistered from the SEC. (Registration and reporting are preconditions to listing on a U.S. exchange.) What distinguishes the deregistered from the stay-registered companies? To answer that question, we examine and evaluate the performance profitability profile of the deregistered companies compared to those that have not deregistered. We focus not on the effects of Sarbanes-Oxley on deregistered firms, rather, we examine their financial profitability profile.

We review data for firms over a seven year period, beginning in 2000, before the passage of Sarbanes-Oxley, to determine whether deregistered firms had differential performance when compared to the stay-registered firms. We limited ourselves to collecting data from four countries, Great Britain, France, Germany, and Italy, as a pilot study to determine whether further research is warranted.

We used data from the SEC and from Datastream. The SEC's Division of Corporation Finance maintains a database of international registered and reporting companies.[89] International registered and reporting companies are FPIs subject to the SEC registration and reporting requirements under the Securities Exchange Act of 1934. We included FPIs in our analysis if they appeared on the SEC database and company information was available in Datastream. We considered a company to be a delisting firm if, during the period examined, the company dropped off of the SEC's database of registered and reporting companies, in other words, if it appeared in the database for one year but not the next. We considered a company a stay-registered firm if it remained in the database for all years 2000-2006, or from the first year it appeared through 2006.

As of the time of writing, 2007 data is not available. The lack of 2007 data is unfortunate for a number of reasons. First, as discussed, the SEC recently eased the burden on FPIs seeking to deregister from the SEC. Those rules first became effective in 2007. As a result, pent up demand for deregistering may have led to a large number of companies deregistering in 2007 and, therefore, inclusion of the 2007 firms would enhance our data set. Second, as mentioned, in some cases, SEC registrants were required to comply with the provisions of section 404 with their first report filed for the fiscal year ending on or after July 16, 2006. Since FPIs typically do not file quarterly reports, many FPIs were required to make their first filing under the section 404 rules during 2007. It is possible that certain FPIs deregistered in time to avoid meeting that requirement and we would want to include those firms in our data.

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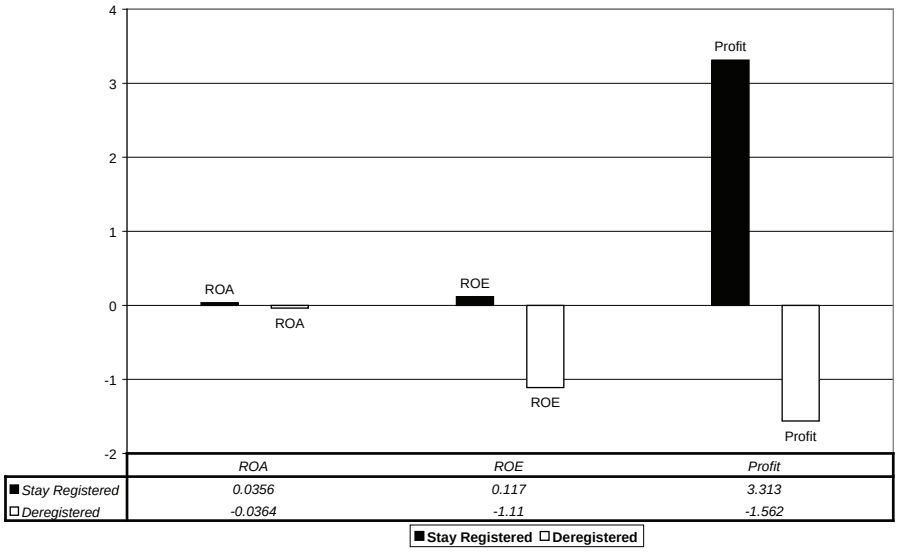
[89] Available at http://www.sec.gov/divisions/corpfin/internatl/companies.shtml, accessed 21 April 2008.

Our preliminary data consists of information from 139 firms: 70 from Great Britain; 32 from France; 24 from Germany; and 13 from Italy. Of the total 139 firms, 56 deregistered. The breakdown of deregistering firms by country is as follows: for Great Britain, 36 of the 70 deregistered; for France 12 of 32 deregistered; for Germany, 6 of 24 deregistered; and for Italy, 2 of 13 deregistered. (We have not included country specific results for Italy given the relative small sample size. The overall trend found in the other samples, however, also is exhibited in the Italian firms.) Once we created the FPI database, we obtained relevant financial data from Datastream for the period 2000 to 2006, including total assets, total debt, total equity, net revenues, earnings per share, and number of shares outstanding. We were then able to calculate average return on assets ("ROA"), average return on equity ("ROE"), and average profit margins for the deregistered compared to the stay-registered FPIs.

The data across all firms indicate a wide range of profitability. ROE ranged from a minimum of −150% to a maximum of 11%. The skewed ROE distribution generated an average ROE of −0.33% across all firms and time. Average profitability, as a proportion of net revenues was 1.57%, and its standard deviation of slightly greater than 36% is indicative of a substantially heterogeneous profit margin picture. ROA exhibited a much tighter range of values, with a mean of 0.1%, and a standard deviation of 0.16%. The deregistered firms, however, had worse performance than the stay-registered firms. The deregistered mean ROE was −1.11%, profit margin was 1.56%, and the ROA was −0.03%. The stay-registered sample indicated an average ROE of 0.12%, mean profit margin of 3.31%, and average ROA of −0.04%. Statistical tests of difference in means indicated each difference significant at 5% or better. A graphical representation of the differences in performance profile can be found in Figure 1.

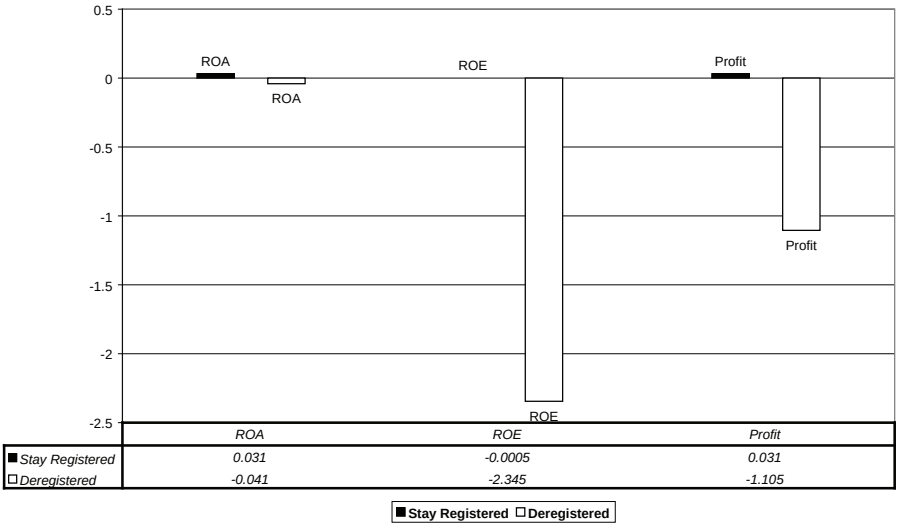
Figure 1
Performance Ratios - All Firms



French firms also exhibited poorer profit performance associated with the deregistered firms. For the deregulated firms, average ROA was −0.04%, mean ROE was −2.34%, and

average profitability was −1.11 %. The associated figures for the stay-registered sample were 0.03 % for ROA, approximately 0 % for ROE, and 0.03 % for profit margin. Although there was no statistical difference between the ROE averages, difference in means tests for ROA and profit margin indicated significance at the 5 % or better level. Given the large ROE deviation between the registered and deregistered sample, the lack of significance in the difference may be surprising. The substantial variation in deregistered data for the French firms is one explanation. A graphical presentation of the differences is presented in Figure 2.

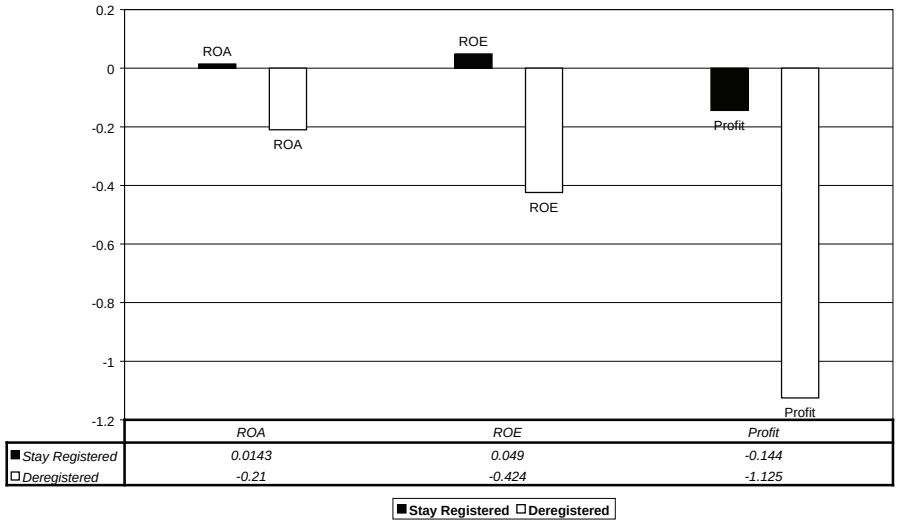
Figure 2
Performance Ratios - French Firms



	ROA	*ROE*	*Profit*
Stay Registered	*0.031*	*-0.0005*	*0.031*
Deregistered	*-0.041*	*-2.345*	*-1.105*

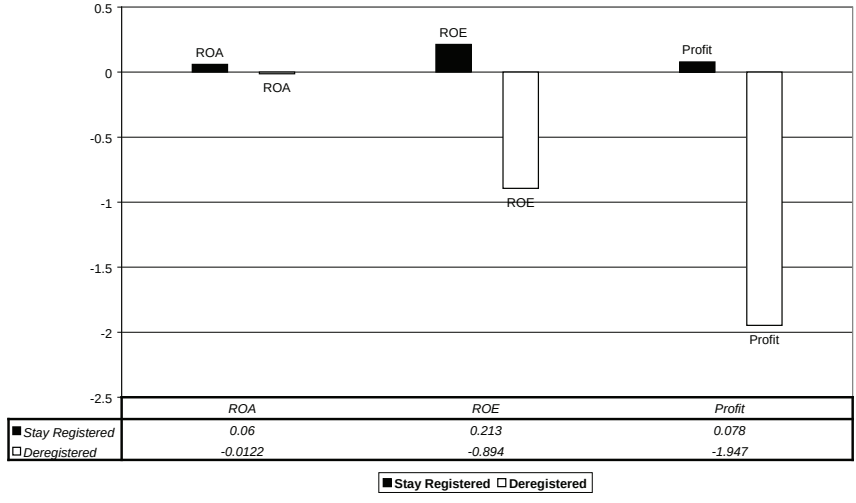
The pattern of relative underperformance continues with the German firms choosing deregistration. Mean ROA was −0.21 %. Average ROE was −0.42 %, and average profitability was −1.13% for the deregistered sample. For the stay-registered sample, mean ROA was 0.01 %, average ROE was 0.05 %, and average profitability was −0.14 %. Differences in mean tests indicated ROA difference was significant at the 1 % level, while ROE difference was significant at the 10 % level. Profit margin difference was not found to be significant in the German firms. A graphical representation of these results is found in Figure 3.

Figure 3
Performance Ratios - German Firms



The country with an almost even number of deregistered and stay-registered firms is the United Kingdom. As a reminder, of the 70 U.K. firms across the sample period, 34 firms stayed registered, while 36 chose to deregister. The profit underperformance trend for the deregistered firms is repeated in the U.K. sample. Average ROA was calculated to be −0.01 %, mean ROE was −0.89%, and profit as a proportion of sales was −1.95 % for the deregistered firms. The stay-registered sample generated the following data: average ROA of 0.06 %, mean ROE of 0.21 %, and average profit margin of 0.08 %. Differences between ROE and profitability were significant at the 10 % or better level, while ROA difference was significant at better than the 1 % level. The graphical representation of the deregistered and registered samples for the U.K. firms can be found in Figure 4.

Figure 4
Performance Ratios - UK Firms



Although the analysis at this stage evaluated a small slice of financial profile or financial performance measures, the profitability differences between registered and deregistered firms is consistent in the aggregate, as well as at the country level. Simply stated, those firms choosing deregistration appear to be relative underperformers, at least in comparison to firms that decide to stay registered. Although the results are preliminary, and limited at this stage by the small number of countries examined and variables used, the differences between stay-registered and deregistered firms are significant and warrant additional investigation. If additional research is consistent with these results, the reasons for deregistration may have more to do with performance and other factors than with regulatory requirements. At this stage, there appears to be a connection between underperformance and registration status that calls for additional investigation.

H. Conclusion

Ever since early evidence suggested that Sarbanes-Oxley might be jeopardizing market competitiveness by making the U.S. exchanges less desirable for FPIs, academics and policy-makers have explored the effects of the new law on firms' decisions to register or deregister their shares in the United States. The reasons FPIs make such decisions are complex and, in most cases, a combination of factors is likely to be at work. Yet gaining a better understanding of such decisions is important. Calls for deregulation, while potentially attractive as a means to encourage more FPIs to list their shares in the United Sates, might be wrong-headed if based on a false assumption that the reason FPIs deregister is to avoid the burden of new regulations.

We have attempted to examine one aspect of FPIs' decisions to deregister from the SEC. The data we have gathered so far indicate that the FPIs that deregister are by and large poor performing firms – they have relatively low return on assets, return on equity, and profit margins. Our data is preliminary, but if the data is replicated when additional countries are examined, then the basis for deregistering and delisting may have little to do with over-regulation and more to do with failure in performance.

Non-U.S. Clients' Reactions to Sarbanes Oxley

Klaus-Michael Thelemann[*]

A. Background Information

The legal and regulatory impact of the "global economy" has been underscored frequently in recent years. This impact has been particularly become more critical for European and U.S. companies, whose annual exchange of goods, services and investment exceeds a trillion dollars. "Domestic" laws now frequently have international consequences, a fact which has created confusion and controversy for businesses on both sides of the Atlantic, but which speaks to a growing mutually beneficial economic integration.

The most recent and most dramatic example of this phenomena occurred with the passage in the United States of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or "SOX"), which was triggered by a sequence of well-known financial scandals, such as Enron, WorldCom and other examples and which had caused a dramatic loss in investors' trust globally.

Sarbanes-Oxley is considered to have effected the most dramatic changes in the U.S. Federal securities laws since the adoption of the Securities Act of 1933 and the Securities Exchange Act of 1934. The new requirements have covered a broad range of topics, such as the composition of Management Boards, independence and oversight of the Accounting Profession, Management Internal Control Evaluation and Reporting, etc.

As part of the latter requirement, mainly three sections of the Sarbanes-Oxley Act are relevant in this context:

Section 404:
Requirement for filing of annual Internal Control Reports/Management Assessments over Internal Controls over Financial Reporting as part of periodic SEC Reporting & Disclosure Requirements, accompanied by an auditor requirement to render additional opinions on both the adequacy of a company's internal control system and management's evaluation procedures (with the latter opinion requirement abandoned in 2007).

Section 302:
Requirement for filing of annual Management Evaluation of Company's Disclosure Controls and related procedures.

Section 906:
Requirement for annual filing of a specific certification statement regarding the correctness of financial statements and related disclosures by the CEO and CFO, with imposition of criminal penalties in case of non-compliance

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B. Major Observations and Practical Insights

As most of the U.S. headquartered companies impacted by the requirements of Section 404 experienced, also non-U.S. companies (foreign private issuers or "FPI's") also significantly underestimated the necessary preparation activities as well as the ongoing implementation efforts which were needed to comply with this piece of regulation of the Sarbanes Oxley Act, resulting in inappropriate management focus and insufficient upfront funding of necessary project budgets.

In many cases, management significantly overrated their existing internal control structures and related maturity levels. Particularly, the documentation status of the internal control system as a crucial prerequisite for necessary recurring evaluation procedures was often found to be outdated, fragmented or simply incorrect.

Management of most companies were surprised when they realized that their external auditors began to take SOX 404 requirements explicitly seriously, which was mainly triggered by the increasing supervision activities imposed by previously founded PCAOB as a truly independent Auditor Supervision Body.

When commencing the SOX 404 compliance exercise, in most instances both company management and external auditors lacked sufficient methodological background and preparation necessary for an efficient implementation of related requirements. In addition, very often a bottom-up approach was chosen and implementation responsibility was delegated to lower management levels without sufficient active involvement and sponsorship of top management. Frequently, however, the underlying rationale from executive management's perspective was the attempt to limit related litigation risk by applying a mechanistic "check the box" and "bottom up/cover it all" approach, rather than following an efficient implementation methodology from the very beginning. Together with a persistent underestimation of the role of IT as part of the SOX 404 projects, this was and still is a significant barrier for an efficient, sustainable and cost efficient implementation. In hindsight, the combination of all of these factors can be viewed as the main obstacle for an efficient implementation, as this approach clearly impeded the application of a real top-down, risk-based approach as it was actually sponsored by the regulators from the very beginning.

Moreover, the increasing liability exposure faced by the accounting profession also contributed significantly to a more "cover-it-all" driven approach as part of integrated fiscal year-end audits applied by most external auditors during the first implementation periods. As a result, in many instances an excessive number of controls was documented and tested, thus contributing to the excessive cost burden many companies experienced in the course of the their SOX 404 implementation projects.

As an additional unfavourable impact of SOX 404 in the early implementation years, in a variety of cases, core business decisions (e.g., timing on investments in the IT environment, e.g. migration or upgrades of ERP systems, or acquisitions/divestitures of business operations, etc.) were postponed or put on hold due to the existing confusion and uncertainty about potential adverse impacts these decisions might have had from a SOX compliance perspective.

In public, however, increasing complaints and push back by companies and their representative bodies led to intense lobbying, resulting – among others – in repeated compliance extension terms granted by the SEC over the recent 5 years. In this context, it appears to be an interesting side remark that these complaints were mainly issued by companies' management and not by their major stake- and/or shareholders. When apply-

ing the concept of regulation as a public good which is financed through redistribution of resources, SOX 404 requirements could be considered to be a trigger to redistribute internal company resources to comply with external regulations, thus directly reduce distributable income for its shareholders. Interestingly enough, shareholders – who ultimately and continuously will be "paying the bill" of this piece of regulation, have not been significantly pushing back the Sarbanes-Oxley Act and its impacts on their companies' indirect cost balances.

This fact is also reflected by a 2006 Global Ernst & Young Survey[1] which revealed that major investor groups and particularly, institutional investors, basically cannot be considered risk averse but are looking for sufficient transparency of risk exposures related to the companies they are investing in and that they do not reward bad or late surprises brought to light unexpectedly in the market place. This attitude is currently also evident outside the U.S., e.g., in less developed capital markets such as in China, where investors are still applying significant risk based discounts on current stock price levels, thus reflecting the fact that they still do not feel confident that the information being presented is accurate, timely and complete and their prevailing lack of overall trust in this market environment and its regulative structures and bodies, respectively.

Furthermore, Lord & Benoit LLC, an U.S. based SOX Research and Compliance firm, issued an interesting empirical study in May 2006, comparing average relative share price movements between companies with material weaknesses as reported in their internal controls over financial reporting as opposed to companies without material weaknesses in their internal controls over financial reporting.[2] The report presented results for nearly 2,500 companies that were registrants one year before Section 404 was required and had submitted at least two Section 404 assertions. The research covered share price movements representing approximately half of the entire market capitalization of all publicly traded companies in the United States between March 2004 and March 2006.

The average share price was separated into three categories:

- Registrants filing both an initial and subsequent year adverse 404 assessment (125 companies);
- Registrants filing a first year adverse 404 assessment followed by a clean 404 assessment (264 companies) and;
- Registrants filing clean assessments in both years (2,092 companies).

The research showed that over the selected two year period there was a:

- 27.67 % increase in the average share prices for companies that had effective controls in both years (8.92 % increase in year one and 18.72 % increase in year two)
- 25.74 % increase in average stock prices for companies that had ineffective 404 controls in year one but effective 404 controls in year two (0.6 % increase in year one and 25.14 % increase in year two).
- 5.75 % decrease in average stock prices of companies that reported ineffective 404 controls in both years (9.85 % decrease in year one partially offset by a 4.11 % increase5 in year two).

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1 Investors on Risk – The need for transparency, Ernst & Young GM, 2006

2 The Lord & Benoit Report: Do the Benefits of 404 Exceed the Cost? Share Price Movements During the Implementation Period of Section 404 Requirements of the Sarbanes Oxley Act – An Empirical Study, Lord & Benoit LLC, May 2006

(Note: As a reference, the Russell 3000 Index increased 18% during the same time frame).

As Lord & Benoit's study further analyses, "these empirical data imply that companies that either historically operated organizations with no material weaknesses in their internal controls, or were able to identify and correct material weaknesses in a timely manner experienced much greater increases in share prices than companies that did not. An investor holding a portfolio of companies at 31 March 2004 who ended up reporting two straight years of adverse 404 assessments would not have been satisfied with those results. An investor holding a portfolio of companies that at first reported an adverse assessment but then remediated their control problems by the second year would have been much more satisfied with their results, but still would not have earned market returns. The only satisfied investor in this circumstance would have been the one that held a portfolio of companies that had two years of clean internal controls."[3]

Even if there are certainly a lot of questions left open when reading this study, one basic result appears to be evident: average stock prices increased at a higher rate for companies with sufficient internal control systems resulting in "effective" grades with respect to their internal controls over financial reporting, compared to companies which either had to remediate reported material weaknesses or were not capable to improve their internal controls.

Accordingly, these results may shed some additional light on the fact why most investors kept remarkably quiet in the course of the ongoing public discussion about the costs and benefits of SOX 404.

In addition and simultaneously, management of many companies meanwhile have been starting to better utilize their existing SOX 404 procedures and to work internally on more sustainable process and systems improvement programmes, thus starting to benefit from the initial burden and to leverage related activities beyond mere compliance. This trend will definitely add to the benefit side of this piece of regulation in the mid and long term.

Accordingly, a significant portion of the current discussion as to what degree the SOX 404 regulation has been contributing to the ongoing de-listing and de-registration activities U.S. stock exchanges are currently experiencing, may be misleading to some extent.

In particular, it might be interesting and worthwhile to conduct a detailed analysis on stock price developments of FPI's in the U.S. over the past years in order to find some answers on the question if SOX 404 really contributed significantly to an unreasonable cost burden, making a U.S. listing more and more unattractive.

My personal perception, however, is that SOX 404 may be considered to be sort of a last straw, but I would hesitate to consider it to be the main root cause for many foreign private issuers to "wave goodbye" to the U.S. stock markets – rather, it appears that the overall extent of SEC reporting and compliance requirements, as well as related overall cost, litigation and reputation exposures (e.g., the Siemens case) is primarily driving the current thought process that both total and incremental cost to stay in this market are considered to be out of balance as compared to other international capital markets, together with the insight that expectations of significant U.S. trading volumes and related benefits were not met in many cases for a significant number of FPI's.

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3 Ibid.

However, as there is a trend to be observed that conditions and related cost to utilize global capital markets are adapting to each other over the mid and long term, it should not be expected that short term arbitrage gains in the regulation "market", which may be realized by listing at other stock exchanges outside the U.S. with less restrictive requirements, will last very long, since most non-U.S. capital markets are currently implementing somewhat similar pieces of regulations (e.g., in Japan, Korea and the European Union, respectively).

The Competition of International Financial Centres and the Role of Law

Douglas W. Arner[*]

According to *Michael Mainelli* and *Mark Yeandle* of Z/Yen, creators of the Global Financial Centres Index (CFCI) for the City of London:

> Financial services is an attractive business sector for cities seeking to develop because it has been a successful, high growth, sector for the past quarter century, and because it is a highly mobile sector, *which can be directly influenced by policy and planning*.[1] (emphasis added)

This has been reflected, especially since the early 1980s, in a string of efforts by countries and cities around the world to develop financial centres, for their domestic economy, for their region and, today, for the global financial system.[2] Recent high profile examples include New York,[3] London and Mumbai.[4]

This chapter looks briefly at some of the factors involved in financial centre development and in the competition to be one of the leading, global financial centres. Overall, the conclusion which emerges is that the development of financial centres is an evolutionary process of strategically building sophisticated human and institutional infrastructure to support the searching for economic opportunities.

At the same time, with the effects of the subprime crisis emanating from the United States still being felt, there has been a questioning of whether the benefits of financialisation are perhaps now being outweighed by the costs. On balance, however, it seems likely that globalisation of finance and the role of global financial centres will continue.

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1 Z/Yen, *The Global Financial Centres Index* (City of London, Mar 2007) ("GFCI 1") 10.

2 J. Sell, *Magnets for Money: A Special Report on Financial Centres*, The Economist, 15 Sep 2007.

3 See McKinsey & Co, *Sustaining New York's and the US' Global Financial Services Leadership* (City of New York, 2006); *Commission on the Regulation of U.S. Capital Markets in the 21st Century: Report and Recommendations* (US Chamber of Commerce, 2007).

4 Ministry of Finance of India, *Report of the High Powered Committee on Making Mumbai an International Financial Centre* (New Delhi, Feb 2007).

A. Financial Centres

I. Network Model

Until the end of the 20th century, the network model dominated most discussions of relationships between financial centres. In this model, financial intermediation was viewed as taking place at multiple levels, with each level feeding into the next and eventually centring on a small number of domestic and international financial centres. As an example, financial services firms such as banks, securities firms or insurance companies might sell products and services to retail and corporate customers in smaller cities. Financial resources would then be allocated in various regional centres before being finally intermediated through a single domestic financial centre, which in turn would interact with a regional or international centre, thus forming a networked wheel-and-spoke relationship between local, domestic, regional and international financial centres. One can surmise that the relevance of this model grew out of the Bretton Woods international financial design, based on closed domestic financial markets, open markets for trade and fixed exchange rates.[5] This system necessarily would have required structured relationships between domestic financial centres (especially those in major economies) with a number of international centres (including niche/offshore centres) in a wheel-and-spoke arrangement. Such an arrangement would have been necessary in the context of largely closed domestic financial systems, but with offshore/euromarkets linkages. With the return towards financial globalisation since the late 1980s however this model no longer fits with the changed nature of international finance, with largely open capital markets and floating exchange rates. In such an environment, funds providers, users and intermediaries are increasingly able to interact directly in major centres around the world without the need for channelling through a layered system of centres with specialised roles.

Such globalisation (at least at the wholesale level – retail finance remains, even in the European Union, largely isolated domestically) has led to a range of arguments suggesting that financial centres will become unnecessary, as participants can be anywhere and deal with one another at will through technology. Unfortunately, this idealised picture is based on the premise that financial markets tend towards efficiency, with rational behaviour, perfect information, free competition and zero transactions costs. Of course, none of these elements of the model actually apply in practice, with the reality underlining the continued significance of financial centres and possibly also the rationales behind their promotion, development and competition.

Nonetheless, the network model does remain relevant in some contexts: collection of funds, distribution of financial products, intermediation/coordination, and trading. In relation to collection of funds, financial centres do often seem to function in a networked fashion, with national financial centres collecting funds from domestic regional centres, especially at the retail level. At the same time, certain centres serve as collection points for funds in individual currencies, at national, regional, international and global levels. Likewise, distribution of financial products does in some cases still reflect the opposite path to collection, although increasingly distribution functions are collected to the greatest extent possible within a single intermediary or financial group. Nonetheless, domestic and regional restrictions may make it impossible to operate a single distribution model

5 See D. Arner, *Financial Stability, Economic Growth and the Role of Law* (Cambridge University Press, 2007) ch 2.

and thus network structures remain relevant. In addition, very large fundraisings (for example, syndicated loans or securities offerings) may be beyond the capacity of any single intermediary/group, resulting in the use of networked structures.

Beyond collection and distribution, centres play a significant role in intermediation and coordination of global activities. As discussed in greater detail below, governance, human capital and liberalisation factors tend to dominate in such roles. Unlike other functions, trading does seem much more susceptible to locational globalisation, with in many cases no need to be in the midst of a major financial centre. Nonetheless, the actual infrastructure of trading (settlement, custody, liquidity etc) falls into the intermediation/coordination context.

II. Role Differentiation

Generally speaking, six main forms of financial centre can be identified: global, international, regional, niche, domestic national and domestic regional. (Z/Yen in the GFCI suggest five main forms of financial centre: global, international, niche, national and regional.[6]) Today, it is generally agreed that New York and London are the only two truly global centres. (New York is also a major domestic national centre and London is the leading centre for a region – Europe – and a national centre.) Hong Kong is an international but not necessarily global centre, while Singapore and Johannesburg are examples of regional centres, with Singapore a regional centre for Southeast Asia/ASEAN and Johannesburg for Southern Africa and possibly Sub-Saharan Africa. Chicago (exchange traded commodities and derivatives), Bermuda (insurance) and Zurich (asset management) are leading niche centres. Examples of domestic national centres include Shanghai and Sao Paolo, while Chicago is a domestic regional centre (as well as a niche centre).

Beyond classification, it is also possible to look to the environment from which a given centre has emerged (or may emerge). Generally speaking, these seem to fall into three main types: trade/commerce, capital mobilisation and asset protection.

A number of centres (including Amsterdam, London and Hong Kong) all emerged from Charles Kindleberger's classic trading centre model, with finance being built on successful international commercial business, often with merchants gradually moving from commerce to property and finance.[7] However, not all centres have emerged from this model; these tend to be in first-mover economies. Others have emerged out of the necessity of building an economy to compete with the first-movers. In this context, a financial centre emerges more by design, intent or need than opportunism, as has often been the case with the commercial centres. Examples in this context would include New York, Berlin, Frankfurt, Tokyo and Shanghai. Reflecting their background, today, New York and Shanghai remain much less centres of international trade finance than London or Hong Kong. At the same time, this context highlights that there can be different forms of financial centre which are not necessarily market based, with Moscow in the Soviet period and Tokyo prior to the 1990s as examples of financial centres emerging from the requirements of specific developmental models. Finally, certain centres have emerged essentially as centres of stability in the context of instability in neighbouring

6 GFCI 1, above note 1, 14.

7 See C. Kindleberger, *A Financial History of Western Europe* (Oxford University Press, 1993 3rd ed.).

major economies. Examples would include Switzerland during much of the twentieth century, Singapore in Southeast Asia, Hong Kong in relation to China and Dubai in the Middle East.

Across this typology, the GFCI also defines financial centres as "leaders", "minor", "volatile" and "evolving", with the last category probably the most significant for possible future development and including such centres as Dubai and Shanghai.[8]

B. Financial Centre Development

According to Youssef Cassis in the most comprehensive historical study to date, the following are the most significant necessary (if not sufficient) conditions for the development of international financial centres:[9]

- Stability of political institutions;
- Strength of the currency;
- Sufficient savings that can readily be invested abroad;
- Powerful financial intermediaries;
- Firm but not intrusive state supervision;
- Light tax burden;
- Highly skilled workforce;
- Efficient means of communication; and
- Plentiful, reliable and widely accessible information.

Generally speaking, it is hard to quibble with this list, although it provides little in the way of specific guidance for those seeking to support the development or competitiveness of specific centres.

I. Financial Sector Development

Not surprisingly, development of a financial centre requires serious attention to financial sector development.[10] Developing a financial system requires an expansion of both the supply of and the demand for finance. The primary policy concern is the design of systems with a view to encouraging participation by domestic and foreign participants and increasing the efficiency of their functioning while at the same time minimising risks of crisis – that is, achieving financial stability and financial development in such a way as to support economic growth.

In looking at financial development, a financial system can be classified as basic, functioning, developed or sophisticated.

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8 GFCI 1, above note 1, 20.

9 Y. Casis, *Capitals of Capital: A History of International Financial Centres, 1780-2005* (Cambridge University Press, 2006) 279.

10 See generally Arner, above note 5 for a full discussion.

A "basic" financial system typically comprises simple currency, simple payment, simple banking, and simple insurance activities. David Beim and Charles Calomiris suggest that:[11]

> [t]he most primitive function of a financial system is to issue and safeguard money. The next function to evolve is a payments mechanism, typically a check-clearance system, which enables parties to transfer money among each other without taking the risk of delivering it in coin or currency. These basic functions are the domain of banks, which are invariably the first financial institutions to evolve in a developing country.

A "functioning" financial system provides financing functions beyond the basic level namely currency, payment, banking and interbank, insurance, simple securities, and simple derivatives transactions. Such a system will also provide a basic level of risk management.

A "developed" financial system provides for effective allocation of resources via market pricing, as well as a variety of instruments and risk management functions. According to Beim and Calomiris:[12]

> In a fully developed, competitive economy the financial system includes not only banks but also securities firms, specialized financial intermediaries such as finance companies and mortgage brokers, as well as institutional investors such as insurance companies, pension funds, and mutual funds. Such a financial system plays a large and sophisticated role: It encourages and mobilizes private saving and investment, and channels the capital so created into its most productive uses. It creates a diverse menu of saving and investment options for individuals – some at higher risk, some at lower risk, some for the long term, and some for a shorter term.

A "sophisticated" financial system will provide a full and ever-changing range of products and services; truly sophisticated systems, however, to date have only developed in a few major financial centres around the world (e.g., London, New York, Hong Kong). In summary, an international financial centre requires[13]:

- An efficient, liquid, large and globally connected equity market that can support equity issuance by both domestic and foreign issuers.
- A liquid and efficient debt market with a traded yield curve in the domestic currency that enables global corporate and sovereign issuance.
- A large and liquid currency trading market.
- Robust derivatives markets that permit trading of a variety of risks, including credit, interest rate, maturity and duration, currency and political.
- Efficient and globally open banking markets that minimise conflicts of interest.
- Globally efficient insurance and re-insurance markets open to global players with all the necessary products and services available.

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11 D. Beim & C. Calomiris, *Emerging Financial Markets* (McGraw-Hill 2001) 44.

12 Ibid.

13 Ministry of Finance of India, above note 4, 19.

In supporting the development of a sophisticated financial sector, the focus today is on a range of legal, institutional and policy factors which can be summarised as "governance".

II. Governance and Financial Development

A range of legal and regulatory infrastructures facilitate financial development and innovation.[14] At the most basic level are the institutional underpinnings of governance and public order, property rights and their protection, contract enforcement and commercial dispute resolution, and human capital development Without these, successful financial centres can fail (e.g. Amsterdam in the 18th century, Beirut in the 20th). As noted below, human capital development is a key constraint to financial centre development.

At the second level are the foundations of finance: First, on the basis of the institutional underpinnings outlined above, it is necessary to be able to use property rights for finance, including through secured transactions (with the legal framework necessary to address use of real, moveable and intangible property security) and leasing. Second, in a modern market-based financial system, company law providing a graduated framework for small, other private, public and listed companies is essential. Third, any jurisdiction requires a sustainable fiscal and taxation system, designed to support especially the institutional underpinnings highlighted previously. Fourth, a financial centre requires a stabile macroeconomic and monetary policy and supporting institutional framework to provide the appropriate environment for finance to take place.

On the basis of the first level institutional underpinnings and the second level foundations, the third level focuses on more sophisticated financial infrastructure:

- Insolvency frameworks;
- Financial information, including accounting, auditing, and credit information mechanisms such as ratings agencies and credit bureaus;
- Corporate governance, with differentiated requirements for differing levels of corporate development;
- Payment and settlement systems;
- Market integrity and corruption, including mechanisms to address money laundering, financial crime and corruption; and
- Government securities markets.

In this context (with the exception of the United States), international accounting standards are probably required as is extensive effort in respect of corporate governance and market integrity. Competition between financial centres does take place at this level (especially in relation to corporate governance) but generally speaking, sophistication in all of these elements is necessary to support the functioning of an international financial centre.

On the basis of this mass of legal, institutional and policy structures, financial regulation becomes a major concern, including banking, securities and derivatives (which are highly dependent on legal and regulatory infrastructure), insurance and pensions. It is in this area in which major international financial centres increasingly compete, on the basis that absent the first three levels, it is probably impossible to support a competitive

[14] Arner, above note 5.

international financial centre. Sophisticated treatment is necessary for a comprehensive centre, but less necessary in the context of a niche centre, focusing on a single financial sector (e.g. Bermuda/insurance, Bahrain/Islamic banking). It is in these areas in which attention is turning in the wake of the subprime crisis and significant failures in the world's two global financial centres: Northern Rock in London and Bear Stearns in New York.[15]

Beyond these elements, there are also a number of second level considerations, which are probably necessary to move beyond the role of domestic or niche centre to that of regional, international or global, including liberalisation and openness to competition, whether domestic, regional or global; financial innovation (arguably an area in which a common law legal system provides a certain advantage[16]); financial regulatory structure, especially effectiveness, independence and accountability; and financial development planning. Subprime responses in the United States and United Kingdom are at the moment focusing on improving regulatory structure and design/planning while attempting to minimise impact on liberalisation/competition and innovation.[17]

In respect of financial innovation, significant research has focused on questions of legal origin and certainly the four leading global/international financial centres as identified by the GFCI (London, New York, Hong Kong, Singapore) are all common law jurisdictions. Nonetheless (and admitting that Amsterdam in its heyday was a common law – albeit Roman Dutch – system and its decline occurred in the context of a French civil law imposition), financial centres have successfully developed with non-common law systems, including Paris, Frankfurt, Zurich, Tokyo and Shanghai. In all likelihood, rather than legal system, the focus should be upon openness to financial innovation in the context of financial centre development (and arguably common law versus civil law frequently serves as a proxy for exactly this).

In addition, financial regulatory structure has over the past decade become an important developmental and competitiveness issue, with the debate frequently framed in these terms in analyses of London (amalgamated regulatory structure) and New York (sectoral regulatory structure).[18] In this context, while structure can indeed be significant, the overall effectiveness of the design of a given structure is probably most important – with recent difficulties in the United Kingdom and United States highlighting exactly this.

III. Regional/International Context

Beyond domestic financial sector and financial centre development, in a world of often global capital flows and increasingly regional economic arrangements, there emerge a range of other considerations beyond the domestic which can have a significant impact on financial centre development, including international and regional arrangements respecting trade in financial services (such as the General Agreement on Trade in Serv-

15 See Financial Stability Forum, *Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience* (Basel, Apr 2008).

16 See J. Dalhuisen, *Dalhuisen on International and Comparative Commercial, Financial and Trade Law* (Hart 2007 3rd ed.).

17 See US Department of the Treasury, *Blueprint for a Modernized Financial Regulatory Structure* (Washington DC, Mar 2008).

18 See D. Arner & J. Lin, *Financial Regulation: A Guide to Structural Reform* (Sweet & Maxwell Asia, 2003).

ices or the EU's Financial Services Action Plan), monetary affairs (such as currency arrangements/unions), cross-border taxation, and transnational institutional arrangements dealing with finance (such as the International Monetary Fund, Bank for International Settlements and Financial Stability Forum). In this context, because international negotiations on financial services trade are largely stalled in the context of the Doha Round while the international institutional arrangements addressing finance are not really appropriate to the realities of global finance,[19] increasing attention has turned to regional arrangements,[20] with the consequent competition to fulfill regional financial centre roles in a variety of regions. Examples include competition between London, Paris and Frankfurt (and to some extent Zurich) in the European Union, between Dubai, Bahrain and Qatar in the Gulf, and between Hong Kong and Singapore in Asia.

C. Financial Centre Competition

A series of studies for the City of London have concluded that the key factors for financial centre competitiveness, in order of importance, are:[21]

1. Availability of skilled personnel
2. Regulatory environment
3. Access to international financial markets
4. Availability of business infrastructure
5. Access to customers
6. A fair and just business environment
7. Government responsiveness
8. Corporate tax regime
9. Operational costs
10. Access to suppliers of professional services
11. Quality of life
12. Cultural and language issues
13. Quality and availability of commercial property
14. Personal tax regime

In the most comprehensive analysis to date, the GFCI focuses on five areas of competitiveness: people, business environment, market access, infrastructure, and general competitiveness.[22] For each factor, the survey combines data from a variety of sources to

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19 See R. Weber & D. Arner, *Toward a New Design for International Financial Regulation* (2008) 29 University of Pennsylvania Journal of International Law 391.

20 See D. Arner, P. Lejot & W. Wang, *Financial Integration in East Asia* (2009) Singapore Yearbook of International Law (forthcoming).

21 Centre for the Study of Financial Innovation (CSFI), *Sizing up the City – London's Ranking as a Financial Centre* (City of London, Jun 2003); Z/Yen, *The Competitive Position of London as a Global Financial Centre* (City of London, Nov 2005); GFCI 1, above note 1. See www.cityoflondon.gov.hk.

22 Z/Yen, *The Global Financial Centres Index 3* (City of London, Mar 2008) ("GFCI 3") GFCI 1, above note 1, 11.

arrive at an aggregate rating. In addition, the GFCI incorporates survey data of opinions of market professionals.

Global Financial Centres Index

Financial Centre	GFCI Mar. 2008	GFCI Oct. 2007	GFCI Mar. 2007
London	1/795	1/806	1/765
New York	2/786	2/787	2/760
Hong Kong	3/695	3/697	3/684
Singapore	4/675	4/693	4/660
Zurich	5/665	5/666	5/656
Frankfurt	6/642	6/649	6/647
Geneva	7/640	7/645	10/628
Chicago	8/637	8/639	8/636
Tokyo	9/628	10/625	9/632
Sydney	10/621	9/636	7/639
Boston	11/618	12/621	14/609
San Francisco	12/614	14/608	13/611
Dublin	13/613	15/605	22/579
Paris	14/612	11/622	11/625
Toronto	15/610	13/613	12/611
Jersey	16/607	Not rated	Not rated
Luxembourg	17/605	17/596	26/570
Edinburgh	18/604	20/587	15/605
Guernsey	19/603	Not rated	Not rated
Washington DC	20/597	18/589	20/594
Isle of Man	21/597	21/583	Not rated
Glasgow	22/592	Not rated	Not rated
Amsterdam	23/585	16/599	23/577
Dubai	24/585	22/575	25/570
Cayman Islands	25/575	24/564	16/604
Gibraltar	26/574	Not rated	Not rated
British Virgin Islands	27/574	Not rated	Not rated

Financial Centre	GFCI Mar. 2008	GFCI Oct. 2007	GFCI Mar. 2007
Hamilton, Bermuda	28/573	25/562	17/603
Melbourne	29/573	19/588	18/603
Montreal	30/560	28/538	21/580
Shanghai	31/554	30/527	24/576
Stockholm	32/553	26/554	29/558
Vancouver	33/548	31/525	27/558
Brussels	34/548	27/546	31/540
Munich	35/546	29/535	Not rated
Bahamas	36/544	Not rated	Not rated
Monaco	37/522	Not rated	Not rated
Milan	38/520	32/519	30/546
Bahrain	39/514	44/455	Not rated
Helsinki	40/512	33/518	32/537
Johannesburg	41/511	43/463	Not rated
Madrid	42/509	34/516	28/558
Vienna	43/507	35/515	35/518
Copenhagen	44/502	38/488	34/525
Oslo	45/495	37/500	33/529
Beijing	46/493	39/482	36/513
Qatar	47/491	47/440	Not rated
Mumbai	48/481	41/470	39/460
Rome	49/471	40/479	38/474
Osaka	50/469	36/502	Not rated
Prague	Below 50	45/454	41/453
Wellington	Below 50	46/447	37/508
Warsaw	Below 50	48/438	38/474
Sao Paulo	Below 50	49/434	Not rated
Lisbon	Below 50	50/422	42/453
Budapest	Below 50	Below 50	44/425
Moscow	Below 50	Below 50	45/421
Athens	Below 50	Below 50	46/395

Source: City of London (www.cityoflondon.gov.hk/gfci)

By contrast, writing in 2006, Casis suggests that the five most significant international financial centres were New York, London, Tokyo, Frankfurt and Paris.[23]

Of most relevance for present purposes are business environment and market access. The following "business environment factors" are aggregated:[24]

- Administrative and Economic Regulation (OECD)
- Business Environment (EIU)
- Total Tax Rates (World Bank/PwC)
- Corporate Tax Rates (OECD)
- Employee Effective Tax Rates (PwC)
- Wage Comparison Index (UBS)
- Personal Tax Rates (OECD)
- Total Tax Receipts (as a percentage of GDP) (OECD)
- Ease of Doing Business Index (World Bank)
- Opacity Index (Kurtzman Group)
- Corruption Perceptions Index (Transparency International)
- Index of Economic Freedom (Heritage Foundation)
- Economic Freedom of the World Index (Fraser Institute)
- Financial Markets Index (Maplecroft)
- Political Risk Score (Exclusive Analysis)
- Operational Risk Rating

In respect of "market access", the following are aggregated:[25]

- Capital Access Index (Milken Institute)
- Securitisation (IFSL)
- Share and bond trading: value and volume of sharing trading, volume of trading investment funds, value and volume of bond trading (World Federation of Stock Exchanges)
- Global Banking Service Centres (taking into account numbers of banks and transactions volume for banking, derivatives, foreign exchange etc) (GaWC Research)
- Global Accountancy Service Centres (GaWC Research)
- Global Legal Service Centres (GaWC Research)
- International Finance Index (Dariusz Wojcik)
- International Finance Location Quotient (Dariusz Wojcik)
- International Finance Diversity Index (Dariusz Wojcik)
- Global Connectivity (Mastercard)
- Total Capitalisation of Stock Exchanges (World Federation of Exchanges)

In 2003 and 2005, survey results placed "availability of skilled personnel and the flexibility of the labour market as the most important factors in the competitiveness of a financial centre."[26] In 2007, this factor was supplanted by the business environment, specifically the regulatory and tax environments, with regulation (e.g. Sarbanes-Oxley legislation in the United States) of most significance in relation to New York and corporate taxation

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23 Casis, above note 9, 280.

24 GFCI 3, above note 22, 37.

25 Ibid, 42.

26 GFCI 1, above note 1, 26 & 49.

in London.[27] In looking forward, the March 2007 GFCI expected "quality and cost" to be the key competitiveness factor.[28] In March 2008, the GFCI survey respondents once again indicated that issues related to business environment were the most significant area of competitiveness between financial centres, with a focus on clear and stable regulatory and tax regimes as well as bureaucracy.[29]

Nonetheless, Z/Yen itself concluded (following earlier results) that human resources issues were in fact the most significant aspect of competitiveness, highlighting the need for financial centres to either grow (through education and training) or buy (through labour and immigration flexibility) the necessary human resources.[30] Today, competition for these resources is indeed increasingly global, with financial centres and firms recruiting staff from around the world.

As financial centres converge on international standards in the areas of legal, institutional and policy infrastructure outlined in the previous section (which are now generally agreed to set the minimum floor acceptable to the markets), these factors of quality, cost and human resources are indeed likely to become paramount in competition at the margin. At the same time, historical analysis suggests another factor which perhaps provides a better indication as to the possible emergence of other global financial centres in coming years.

D. Looking Forward

According to the March 2007 GFCI:[31]

> Nobody we spoke to believes that London or New York City will lose their positions as global financial centres within the next ten years. If London and New York fall in popularity it will be due to a fundamental, unforeseen, alteration in one or more of the factors that make financial centres attractive.

Casis suggests how this has occurred in the past:[32]

> … [T]he demise of an international financial centre is usually triggered off by a military cataclysm – irrespective of the outcome, whether victory or defeat.

Hopefully, this will not be the triggering factor for change. At the same time, in looking forward, another potential factor does seem likely to come into play:

> A first conclusion prompted by long-term historical analysis is that the rise of a major centre is closely linked to the economic power of the country that hosts it. … Each of the three cities (Amsterdam, London and New York) successively ranked a the top in world finance since the end of the eighteenth century has at the same time been

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27 Ibid, 49.

28 Ibid., 20.

29 GFCI 3, above note 22, 56.

30 See ibid, 27-31.

31 GFCI 1, above note 1, 46.

32 Casis, above note 9, 281.

> the financial centre of the dominant national economic of the day … The ranking of the centres and that of the economies do not match exactly, since the emergence of a major international financial centre follows, with some degree of time-lag, a nation's rise to being a great economic power.[33]

I. Economic and Financial Factors

In this context, recent global economic data does in fact suggest the probable locations for the most significant global financial centres, with real GDP figures providing a good proxy for today's leading financial centres and GDP at purchasing power parity (PPP) providing an indication of probable locations of future major financial centres:

		2007 GDP (share, ppp)	2007 GDP (share, market exchange rates	2007 Exports (share, goods and services)	Population (share)
1	United States	21.4	25.5	9.6	4.7
	Euro area (15 countries)	16.1		29.5	4.9
2	China	10.8	6.0	7.8	20.5
3	Japan	6.6	8.1	4.7	2.0
4	India	4.6	2.0	1.3	17.5
5	Germany	4.3	6.1	9.2	1.3
6	United Kingdom	3.3	5.1	4.2	.9
7	Russia	3.2	2.4	2.3	2.2
8	France	3.2	4.7	4.0	1.0
9	Brazil	2.8	2.4	1.1	2.9
10	Italy	2.8	3.9	3.7	1.0
	Spain	2.1		2.2	.7
	Mexico	2.1		1.7	1.6
	Canada	2.0		2.9	.5

Source: IMF, *World Economic Outlook* (Apr. 2008), 45 table 1.2 & Statistical Appendix, 235

Given the increasing importance of regional economic arrangements and also the development of financial centres serving individual regional economies, data along these lines are perhaps of even greater significance (and perhaps also explain London's increasing challenge to New York). Specifically, in terms of share of world GDP, the European Union is now slightly more significant than the United States/NAFTA area (including Canada and Mexico) (and even larger if Switzerland is included). Further, the EU's share

[33] Ibid, 279-80.

of trade is larger than that of the United States. In addition, at PPP rates, China is now the world's second largest economy (and even larger when Hong Kong is included) and India, Russia and Brazil are among the ten largest.

Beyond simple economic size, savings and investment flows also highlight areas of significance in the context of global finance, with the United States being a net debtor, the European Union in rough balance and Japan, China, India, Russia and the Middle Eastern oil exporters net creditors. Nonetheless, in terms of global financial stock as of 2006, the United States remained the most significant but with lower growth rates than Europe and Asia:

Global Financial Stock (equities, private debt, government debt, bank deposits)

	US$ trillions, 2005, %	01-05 growth rate:
US	51	6.5%
UK/Eurozone	38	
UK	8	8.4
Eurozone	30	6.8
Japan	20	7.5
Asia-Pacific ex-Japan	13	15.5

Source: McKinsey & Co. (2006), 9

In relation to investment banking, even in 2005, the United States was no longer dominant and the figures for 2007 would likely show much greater parity between North America, Europe and Asia:

Investment Banking and Sales & Trading Revenues, US$ bn, 2005

	Investment Banking	Sales & Trading	Total
US	40	69	109
EU 15 + Switzerland	24	74	98
Asia	7	30	37

Source: McKinsey & Co (2006), 11

Further, in 2006, the United States trailed both Europe and Asia in large IPOs:

IPOs in excess of US$ 1 billion (Jan.-Nov. 2006), %

US	16
Europe	63
Asia	22

Source: McKinsey & Co (2006), 44

Overall, one can say that economic hinterland indicate that we will see increasing competition between financial centres in major regions (especially in East Asia and the Middle East) and between international financial centres serving different regions. At the same time, increased globalisation of finance suggests that the major centres will become increasingly interlinked in intermediating flows between different countries and regions.

II. Other Factors

Beyond economic and financial significance, Samuel Huntington has suggested that increasingly the world, economically and politically, will organise along civilisational lines, with major civilisations forming economic and political groupings e.g. Western, Islamic, Japanese, Chinese, Indian.[34] Is it likely that financial centres also will compete along civilisational lines? Recent work from Amir Licht and others suggestions this may in fact be likely to some extent.[35] To some extent, it seems very reasonable that financial centres will develop to serve economic areas with some aspects of cultural commonality, as has been the case with London and New York for Europe and North America. As such, significant international financial centres serving East Asia, Southeast Asia, South Asia, and the Middle East would appear likely from both cultural and economic aspects.

This division is also to some extent also related to time zones: financial centres frequently often target time zones, with a general focus on the Americas, Europe, the Middle East and East Asia. This is already taking place and is likely to remain a significant area of competition, especially in East Asia and the Middle East.

At the second level are the sorts of factors identified by the GFCI, with regulatory issues being the most likely.[36]

Reflecting the preceding analysis, in its report on Mumbai's prospects as an international financial centre, the following seven factors are identified in relation to competitive advantage in international financial centre development and competition[37]:

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[34] See S. Huntington, *The Clash of Civilizations and the Remaking of World Order* (Simon & Schuster, 1996).

[35] See J. Siegel, A. Licht & S. Schwartz, *Egalitarianism and International Investment*, mimeo, Jun 2007.

[36] GFCI 1, above note 1, 50.

[37] Ministry of Finance of India, above note 4, xiii-xiv.

- An extensive national, regional and global network of corporate and government (supranational, sovereign, sub-sovereign and local) client connections possessed by financial firms involved with an international financial centre.
- High level human capital specialised in finance, particularly quantitative finance, supported by a numerate labour force providing lower level paraprofessional accounting, book-keeping, compliance and other skills.
- World-class telecommunications infrastructure with connectivity around the clock and around the world.
- State-of-the-art information technology systems, capability to help develop, maintain and manage the highly sophisticated and expensive IT infrastructure of global financial firms, trading platforms and regulators – systems that are evolving continuously to help firms retain their competitive edge.
- A well-developed, sophisticated, open financial system characterised by: (1) a complete array of proficient, liquid markets in all segments, i.e. equities, debt, commodities, currencies and derivatives; (2) extensive participation by financial firms from around the world; (3) full integration of market segments, i.e. an absence of artificially compartmentalised, isolated financial markets that are barred from having operational linkages with one another; and (4) absence of protectionist barriers and discriminatory policies favouring domestic over foreign financial firms in providing financial services.
- A system of financial regime governance (i.e. embracing legislation, policies, rules, regulations, regulatory agencies etc.) that is amenable to operating on global "best-practice" lines and standards.
- A "hinterland advantage" in terms of either a national or regional economy (preferably both) whose growth is generating rapid growth in demand for international financial services.

E. Financial Centre Competition and Competitiveness

In looking at these factors (which could be summarised as governance, sophistication, liberalisation, participation, human capital, IT, and hinterland), while certain factors are more amenable to government support than others, all are areas in which governments can act to enhance competitiveness.

Overall, one could suggest that beyond the core economic factors highlighted above (pace Casis), governance (including legal and regulatory issues) appears to be at the centre of financial centre competitiveness and the one most subject to influence in the short and medium term. As discussed in preceding sections, governance factors are essential not only to competitiveness but also sophistication, liberalisation, and participation. Sophistication issues result from actions or inactions to encourage financialisation, an issue/objective which the subprime crisis has highlighted may in fact not be appropriate and/or desirable for every economy. Sophistication thus also relates to issues of liberalisation: a fully liberalised financial system, open to global competition is probably essential for an international financial centre (though by not to a similar extent for a domestic financial centre). As such, domestic economic objectives may conflict with the emergence of a domestic international financial centre in certain economies. Participation in turn relates to liberalisation, at least to the extent that one is concerned with global

participation as opposed to merely domestic participation. In addition however financial sector development even at the purely domestic level is based on increasing domestic savings and investments, through enhanced participation in the formal economy and financial system. Once again, governance factors (especially in relation to the first level institutional underpinnings) play a key role here.

There is also a clear relationship between the economic/financial hinterland of any given financial centre and legal and governance strategies. For instance, economic area can be increased through the formation of national, regional and international economic zones. In this respect, the development of the European Union and especially its integrated market for wholesale finance highlight the potential that may exist in other regions, with specific examples currently in ASEAN and the Gulf Cooperation Council (GCC).

The remaining two factors (technology and human capital) are perhaps of less interest from a purely legal standpoint but are of high interest from an academic standpoint as well as that of governments. As noted above, human capital may be the key factor in financial centre competitiveness, or at least one of the two key factors along with governance. (Further, technology in many ways will come with competitiveness in governance and human capital.) Human capital development requires extensive government commitment to developing domestic resources through well-designed education and healthcare systems (which in turn depends largely on an effective fiscal regime – one of the fundamental underpinnings discussed above) at the domestic level. Success in this area can be said to be a major factor in successful economic development. At the same time, financial centre competitiveness requires more than successful domestic human capital development, it also requires an openness to human capital from outside the jurisdiction – as the markets are global, the players are global and the competition for the best people is also global. In this way, once again, developing a competitive international financial centre may not necessarily coincide with other domestic economic, political and social objectives.

In looking forward, one can identify the parameters of the competition of financial centres – a competition in which law play a central role. At the same time, developing a competitive international financial centre (as opposed to an effective domestic financial centre) may conflict with other objectives of a given country/society/economy, even in terms of competitiveness (for instance, it may be to a given country's advantage to restrict certain aspects of the liberalisation requisite for a successful international financial centre in the interests of the development of the country's economy as a whole). As such, there are both benefits and costs to the competition for global financial centres.

In the context of Asia, the GFCI suggests that Hong Kong and Singapore will remain the two major international financial centres, with Tokyo and Shanghai stabilising as significant national financial centres.[38] This perhaps could be nuanced, with a suggestion that Hong Kong is likely to emerge as the Chinese international/regional financial centre (a civilisational model), Shanghai as China's domestic financial centre, Tokyo as Japan's domestic financial centre, and Singapore as the ASEAN centre and also a global niche centre for asset management. At this point, India's international financial centre remains an open question, with Mumbai and Delhi competing for the domestic role, and London, New York, Toronto, Dubai, Mauritius, Singapore and Hong Kong all currently playing a role.

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[38] Ibid.

Chapter 4
Intellectual Property Law

The Territorial Dimension of Intellectual Property Law

Volker Michael Jänich[*]

A. Introduction

A company's choice of location depends on a variety of factors.[1] The availability of adequate premises and the labour market must be explored. Also transport connection, proximity to the key market, and the chance to obtain public subsidies influence the decision where to set up a new subsidiary. In addition, the applicable legislation governing corporate, employment, environmental, and tax law must be taken into consideration before a foreign investment is made.

This paper addresses an issue that has received little attention in the past: Does the protection of intellectual property rights influence companies' choice of location?

B. What is IP? Defining intellectual property

The term intellectual property designates a set of exclusive rights that aim at protecting creations of the mind.[2] A typical example is patent law, which protects technical inventions.[3] The inventor can file a request for the grant of a patent with the patent office.[4] Once granted, the patent provides the inventor with an exclusive right for a limited period of time, normally 20 years, during which only the patentee may use the patented invention.[5]

Another intellectual property right is the copyright, which protects the creators of literary, musical, scientific, and artistic works.[6] In contrast to patent law, copyright does not require a state act granting the right, but comes into existence with the creation of

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1 Cf. Hansmann, *Industrielles Management* (7th edition, 2001) Chapter 5; Schweitzer and Bloech, *Industriebetriebslehre* (2nd edition, 1994) Chapter 2 A II; Gasser/Horváth (ed.), *Den Standort richtig wählen* (1995).

2 Götting, *Gewerblicher Rechtsschutz* (8th edition, 2007) Para. 4 No. 1; Loewenheim, *Handbuch des Urheberrechts* (2003) Sec. 1 No. 2.

3 Rogge, in: Benkard (ed.), *Patentgesetz* (10th edition, 2006) Introduction No. 1.

4 Götting (n. 2), Para. 18 Nos. 1 ff.

5 Sec. 9 German Patent Law; Scharen, in: Benkard (ed.) (n. 3), Sec. 9 Nos. 1 ff.

6 Schack, *Urheber- und Urhebervertragsrecht* (4th edition, 2007) No. 1; Schricker, in: Schricker (ed.), *Urheberrecht*" (3rd edition, 2006) Introduction Nos. 1 *ff*.

the work.[7] Like the patent, however, copyright is limited to a certain period of time and usually expires 70 years after the author's death (Sec. 64 German Copyright Law).

Other important rights are the copyright in industrial designs and the trademark. The copyright in industrial designs protects the formal design of products,[8] whereas trademarks protect distinctive signs or indicators that distinguish the goods and services of one company from those of other companies.[9]

The protection provided by these intellectual property rights results from national legislation. On the international plane, various international treaties have established an effective protection system. However, all of these treaties rely on the principle of territoriality, which is not without controversy and shall now be explored.

C. The principle of territoriality

I. A patent law example

In the following, the principle of territoriality is clarified on the basis of an exemplary patent law case.

In a Henkel laboratory in Düsseldorf, a new detergent is invented that without any difficulty removes red wine stains. Under the assumption that this is a patentable invention, still, no intellectual property right arises solely out of the act of inventing. Under German law, the invention is not yet protected – neither in Germany nor in any other state.

II. Obtaining a German patent

It is possible to request a German patent for the detergent. Pursuant to Sec. 1 of the German Patent Law, patents shall be granted for inventions that are new, involve an inventive step, and are susceptible of industrial application. The granting of a patent requires a state act issuing the patent.[10] The invention must be filed for the grant of a patent with the German Patent Office, as follows from Sec. 34 para. 1 German Patent Law. If the application complies with the requirements for the granting of a patent, the German Patent Office issues the patent according to Sec. 49 para. 1 German Patent Law.

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7 Schack (n. 6), Nos. 267 f.; Loewenheim, in: Schricker (ed.) (n. 6), Sec. 7 No. 5.

8 Nirk and Kurtze, *GeschmMG* (2nd edition, 1997) Introduction No. 2; Götting (n. 2), Para. 5 Nos. 25 f.

9 Sec. 3 Para. 1 German Trademark Law; Ingerl and Rohnke, *Markengesetz* (2nd edition, 2001) Introduction No. 66.

10 Bacher and Melullis, in: Benkard (ed.) (n. 3), Sec. 1 No. 2; Kraßer, *Patentrecht* (5th edition, 2004) Paras. 22 I 3 and 23 I 7; BGH 1974 GRUR 146 (147) – Schraubennahtrohr (German Federal Court of Justice); BGH 1999 GRUR 571 (572) – Künstliche Atmosphäre (German Federal Court of Justice).

III. Effects of the patent, Section 9 German Patent Law

Pursuant to Sec. 9 of the German Patent Law, the patent has the effect that the patentee alone shall be authorised to use the patented invention, and any other person can be excluded from the use of the patent.

Yet this exclusive right is regionally restricted and has effect only in the territory of the Federal Republic of Germany.[11] While this is not expressly codified by law, the principle of territoriality ensues from the fact that the Federal Republic of Germany has no authority outside its territory.[12] Therefore, by virtue of a German patent only acts of exploitation undertaken in Germany may be prohibited. In any other country, the patented invention can be used freely.[13]

As in the above example, the result is often dissatisfactory: The detergent's manufacturer does certainly wish to be protected in important foreign markets so that he is able to proceed against competitors using his invention there, too.

However, this requires him to obtain patents in each and every country in which he needs protection for his invention.

IV. International treaties

Since the principle of territoriality requires the separate acquisition of protection in foreign states, numerous international treaties seek to facilitate this process.

1. Paris Convention for the Protection of Industrial Property

The Paris Convention for the Protection of Industrial Property of March 20, 1883, guarantees that in the states parties to the Convention patent protection is as available to foreigners as it is to nationals, which is provided by Art. 2 of the Paris Convention.[14] In addition, it is possible within a certain period of time to claim a foreign right of priority (cf. Art. 4 Paris Convention).

Returning to our exemplary case, the relevance of the Paris Convention is this: The state parties to the Convention are obliged to provide the detergent's producer with the same protection as they grant their own nationals. Hence, the manufacturer enjoys protection abroad under the relevant legislation and can file a request for the grant of a patent for his invention in any country party to the Convention. However he is not protected merely by virtue of his German patent.

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11 BGH 1968 GRUR 195 – Voran (German Federal Court of Justice); Mes, *Pat*G (2nd edition, 2005) Sec. 9 No. 9.

12 Keukenschrijver, in: Busse (ed.), *Pat*G (2003) Sec. 9 No. 116.

13 Kraßer (n. 10), Para 33 V c 2; Kühnen, in: Schulte (ed.), *Patentgesetz* (7th edition, 2005) Sec. 9 No. 80.

14 Ullmann, in: Benkard (ed.) (n. 3), International Part No. 14.

2. Convention on the Grant of European Patents (European Patent Convention, EPC)

The EPC allows the inventor to obtain patents for multiple European states by filing only one application in a uniform procedure.[15] It is important to stress that the Convention does not grant a single right with effect in the designated states. Rather, in compliance with the principle of territoriality, the European Patent Office issues a bundle (cf. Art. 2 EPC) of individual national patents.[16]

3. Patent Cooperation Treaty (PCT)

Under the Patent Cooperation Treaty, it is possible to extend the patent application to various states.[17] This makes it a lot easier for an inventor to obtain national patents in different states. Still, the principle of territoriality persists: the invention does not enjoy transnational protection due to a PCT application, but only by national patents that were granted on the basis of that application.[18]

VI. The principle of territoriality and other rights protecting intellectual property

1. Principle

In general, the principle of territoriality also applies to other industrial property rights.[19] Here, like in patent law, international treaties facilitate the obtaining of protection in other countries. A typical example would be the Madrid Agreement Concerning the International Registration of Marks, which governs the acquisition of protection for trademarks and signs.

2. Copyright – an exception?

Solely with regard to the copyright, the validity of the principle of territoriality is controversial. The discussion centres around the emergence of the copyright, which in contrast to other intellectual property rights originates with the creative act. A state registration is not required. Based on that fact, legal commentators have called for a universal international copyright that acknowledges copyright as a whole.[20] However, this approach, which could be described as the principle of universality, has not yet become accepted.

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15 Götting (n. 2), Para. 31 No. 2.

16 Ullmann, in: Benkard (ed.) (n. 3), International Part No. 104.

17 Kraßer (n. 10), Para. 8 B 4; Götting (n. 2), Para. 7 No. 21.

18 Ullmann, in: Benkard (ed.) (n. 3), International Part No. 82.

19 Götting (n. 2), Paras. 3 No. 2 and 7 No. 8; Fezer, *Markenrecht* (3rd edition, 2001) Introduction Nos. 158*ff.*; Eichmann, in: von Falckenstein (ed.), *Geschm*MG (3rd edition, 2005) Preface No. 13.

20 Schack (n. 6), No. 806.

Copyright is protected internationally, amongst others, by the Revised Berne Convention for the Protection of Literary and Artistic Works. The protection provided by the Berne Convention ensues from the principle of national treatment, whereby states are required to treat aliens equally under the local law compared to their nationals. Thus, in any state party to the Convention, the author is granted the same level of protection granted to authors that are nationals of that state. For example, a German national enjoys the same protection for his works in Canada as Canadian nationals.

Furthermore, the revised Berne Convention grants authors a minimum set of rights in every state, including the author's moral rights and the right of recognition of the authorship of the work.

VII. TRIPs

The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) complements the above mentioned regulations on the protection of intellectual property rights. First, TRIPs obliges state parties to comply with international treaties that protect intellectual property. For instance, Art. 9 para. 1 of the TRIPs Agreement binds states parties to the revised Berne Convention. In addition, the TRIPs Agreement codifies substantive minimum standards of protection. For example, pursuant to Art. 33 of the TRIPs Agreement, a patent must be protected for a minimum duration of 20 years.

In this context, one should note Art. 27 para. 1 2nd Sentence of the TRIPs Agreement, which expressly prohibits any discrimination based on the location where an invention was made.

D. The principle of territoriality and companies' choice of location

I. Patent Law

The question raised in the beginning of this presentation – whether the protection of intellectual property has any influence on a company's choice of location – will first be addressed with regard to patent law and respective exemplary cases.

1. First scenario: choosing a location for a research facility

Due to the principle of territoriality and the fact that for the protection of a patent, it is generally irrelevant where the invention is made, the decision on the location of a research facility or an enterprise doing extensive research work can to a great extent be reached independently from patent law. The only important thing is whether the native country of the inventor is party to the Paris Convention. Since the Paris Convention has 171 member states,[21] this applies for practically any state in the world.

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[21] As of March 1, 2007.

Furthermore, for the grant of protection it is of advantage if the owner of the right is a national of a state party to the WTO (cf. Art. 1 paragraph 1 TRIPs Agreement). This ensures that the owner of the right enjoys the rights provided by the TRIPs Agreement.

2. Second scenario: choosing a location for a production facility

If you search a location for a production facility, patent law can exert an immense influence.

As mentioned before, the patentee's exclusive right has effect merely for the state that granted the patent. Inventors often choose to apply for patent protection only in a few industrialised countries. Hence, anyone could open up a production plant in a state where no patent application has been filed and supply that state's market with the invention. For example, if X holds patents for a radiator valve in Germany, the US and Japan, a competitor could manufacture and sell the protected valve in France. Also, he could export the protected valve from France to other states that the invention does not enjoy protection in.

In this case, countries outside the WTO offer an advantage of location. The non-applicability of the TRIPs standard can attract copycats. However, these gaps in the protection of intellectual property are not solely advantageous: At the same time, the location becomes less interesting to innovative companies doing research (see first scenario above). Thus, the advantages and drawbacks for a non-WTO state cannot be evaluated on general terms, but for each case separately. Depending on the products of the company, patent law and especially its loopholes can be decisive factors in determining the company's location.

3. Law enforcement deficits as a location factor?

Buying a fake Rolex watch is certainly easier in Beijing than it is in Düsseldorf. In some countries, there are severe deficits in law enforcement regarding intellectual property rights. It seems inevitable to conclude that such deficits influence the choice of location: Certainly countries that effectively enforce intellectual property rights must be more appealing as a production location!

In the author's opinion, however, this is generally not the case. It is irrelevant to the counterfeiter of a product where the original is manufactured; the only thing that matters is the access to information on the original product. Hence, whoever wants to plagiarise a Ralph Lauren polo shirt does not care where the original is made.

Other legal aspects can become important in this context, for example the protection of company secrets under criminal law: Is my enterprise effectively protected against industrial espionage? Are there sufficient legal instruments to prevent employees from betraying company secrets? These questions primarily relate to criminal or unfair competition law, not to subject matters of intellectual property law. However, it is important to note that the protection of intellectual property by patents can be rendered void if the law does not provide adequate protection against espionage and the betrayal of company secrets. By way of espionage, it is possible to access an innovation before it is patented. The use of the innovation by competitors would then bar the granting of a patent since the innovation is not "new".

4. Especially: employee inventions law

Employee inventions law can be especially relevant in deciding where to seat a company or its subsidiaries. Employee inventions law governs the conflict between employment and patent law: employment law generally attributes the work result to the *employer*, whereas according to patent law the *inventor* is entitled to the invention.[22] In Germany, this is provided by Sec. 6 Patent Law.

80 per cent of all inventions are made by employed inventors.[23] Employee invention law must solve the conflict between the two regulatory systems. In Germany, this task is assigned to the Law on Employee Inventions.[24]

Pursuant to Sec. 6 of the Law on Employee Inventions, the employer may claim a so called service invention[25] (cf. Sec. 4 para. 2 Law on Employee Inventions).

In case of an unlimited claim, all rights in the service invention shall pass to the employer (Sec. 7 Law on Employee Inventions). However, if the employer declares an unlimited claim, the employee shall have a right to reasonable compensation against his employer, Section 9 Law on Employee Inventions. Thus, the employee receives additional compensation for his invention.[26]

These additional costs for the employer can be avoided by a strategic choice of location for the company since in some countries there are no special rules governing employee inventions. For instance, the US lack detailed regulation of employee invention law. Rather, parties can contractually stipulate that any rights in employee inventions shall be owned by the employer without special compensation.[27]

In this respect, intellectual property rights can indeed influence the choice of location. From the company's perspective, a location may seem preferable where the employee inventor is not granted specific rights. On the other hand, the prospect of additional compensation for inventions can also motivate employees to be more creative.

II. Copyright

It must also be examined whether disparities in the protection of copyright can influence the choice of location. Here, companies producing computer software or films, which are works protected by copyright,[28] might serve as an example.

Copyright does sometimes differentiate according to the place of publication of a protected work. For example, Sec. 121 of the German Copyright Law privileges foreigners who publish their works for the first time in Germany. Still, these distinctions are practically of no importance since international treaties governing copyright, especially the Revised Berne Agreement, guarantee comprehensive protection irrespective of where the work was created or published (cf. Sec. 121 para. 4 German Copyright Law).

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22 Kraßer (n. 10), Para. 21 I a.

23 Keukenschrijver, in: Busse (ed.) (n. 12), Introduction ArbEG No. 1.

24 Götting (n. 2), Para. 16 No. 3.

25 Kraßer (n. 10), Para. 21 II b bb.

26 *Ibid.*, Para. 21 V.

27 Cf. Chisum and others, *Principles of Patent Law* (2nd edition, 2001) 488 *ff*.

28 Cf. e.g. Sec. 2 Para. 1 Nos. 1, 6 German Copyright Law; Art. 10 Para. 2 TRIPs (software); Art. 2 Revised Berne Convention (films).

If there are indeed deficits in law enforcement, these exist irrespective of the place of creation of the work.

Taking a look at the legal relationship between employer and employee, some legal systems are particularly employer friendly.[29] For example, Sect. 201 b) of the US copyright act 1976 originally attributes copyrights to the employer.[30] This may seem as an advantage of location.

E. Conclusion

1. As a rule, intellectual property rights do not influence companies' choice of location.
2. Whenever there are gaps in the protection of inventions, patent law can be the decisive factor in determining the location of the company.
3. Employee inventions law can be especially relevant in deciding where to seat a company or its subsidiaries.

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29 Cf. Rojahn, in: Schricker (ed.) (n. 6), Para. 43 No. 3.

30 Schack (n. 6), No. 979; Schack, 1989 ZUM 267 ff., 280 ff.

Patent Law as an Investment Factor?

Peter Kather[*]

A. Concept of Patent Law

Patents grant a legal monopoly for the use of a patented invention for a defined period of time. Patent law is based on the concept that the patentee is granted such exclusive right, though limited in time, to use the patented invention as a reward for making the invention public instead of keeping the invention as a business secret. Thereby the patentee gets the better chance for the amortisation of his costs of development.

By law, national and international and European Patent Applications are published 18 months after their filing date[1] thereby allowing any third party getting knowledge of the invention to design a bypassing solution, or to further develop, or to develop alternative technical teachings, to solve the technical problem of the invention.

Thus, the patent law system is supposed to support the technical development and the technical progress and thereby the economy in the country granting the limited-by-time monopoly.

Whenever countries not yet having a patent law system discuss the introduction of a patent law system, the discussion focuses on the very question whether a patent law system actually does support the technical development and technical progress or whether, in fact, it rather impedes the technical development and progress by interfering with free trade and allowing a restraint of competition.[2]

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[1] Sec. 32 Subsec. 5; Sec. 31 Subsec. 2 of the German Patent Act (PatG); Art. 93 Para 1 of the European Patent Convention (EPC).

[2] This very basic dispute also took place in Germany in the second part of the 19th century. Werner von Siemens stated in 1863 in his "Positive Vorschläge zu einem Patentgesetz":
„Doch auch abgesehen von der Veröffentlichung erwachsen der Gesellschaft aus der Verleihung des Eigenthumsrechtes an den Erfinder auf eine begrenzte Reihe von Jahren noch wesentliche Vortheile. Nur in den seltensten Fällen ist eine Erfindung in ihrer ursprünglichen Gestalt brauchbar, gewöhnlich und namentlich bei den am meisten eingreifenden und von dem Bekannten und Erprobten abweichenden Erfindungen ist noch eine lange Reihe von Experimenten, ein großer Aufwand von Zeit, Arbeit und Kapital nothwendig, um die allem Neuen entgegentretenden Schwierigkeiten zu beseitigen und der Erfindung eine praktisch brauchbare Form zu geben.
Nur Aussicht auf bedeutenden Gewinn kann zur Aufwendung dieser großen Opfer spornen. Durch den Patentschutz auf eine Reihe von Jahren in Verbindung mit der Vaterliebe, die jeder Erfinder für seine Idee in sich trägt, wird derselbe ein natürlicher Vormund und Sachwalter seiner Erfindung; fehlt es ihm selbst an den nöthigen Mitteln, so schafft sie ihm der Besitztitel auf seine Erfindung; er erhält Kapitalien, um die nöthigen Versuche zur Ausführung zu machen, gegen die Zusicherung eines Anteils am künftigen Gewinn;
There was a strong anti-movement based on free trade arguments in Prussia, where Rudolf Delbrück elaborated a motion for the complete abolishment of any protection for inventions,

B. Substantive Patent Law Provisions

As of today substantive patent law provisions are almost never disputed internationally. Apart from the basic dispute mentioned above only few topics on the question of patentability are in dispute, whereas other patent law questions did not lead to any conflict. Substantive patent law provisions have meanwhile been harmonized to a very high degree, and countries introducing a patent law system have no problem in adopting a system similar to the European Patent Convention (EPC).

I. Patents are granted for inventions, i.e. for technical teachings which are new and are based on inventive step against the state of the art.

"Product"-patents are granted for new and inventive products (e.g. a moisture impervient barrier[3]) or apparatus (e.g. a fluid storage and dispensing system[4]) or substances (e.g. an active ingredient for a pharmaceutical[5]).

"Process"-patents are granted for new and inventive manufacturing or operation processes.

"Use"-patents are granted for new and inventive uses of known products or substances or processes.

II. The scope of protection of a patent is determined by the contents of the patent claim. The description and the drawings, however, shall be used for interpreting the patent claim.[6]

The "Protocol on the Interpretation of Art. 69 of the EPC", which is an integral part of the EPC,[7] explains the principles of interpretation.

> Article 69 should not be interpreted as meaning that the extent of the protection conferred by a European patent is to be understood as that defined by the strict, literal meaning of the wording used in the claims, the description and drawings being employed only for the purpose of resolving an ambiguity found in the claims. Nor should it be taken to mean that the claims serve only as a guideline and that the actual protection conferred may extend to what, from a consideration of the description and drawings by a person skilled in the art, the patent proprietor has contemplated. On the contrary, it is to be interpreted as defining a position between these extremes which combines a fair protection for the patent proprietor with a reasonable degree of legal certainty for third parties.
>
> For the purpose of determining the extent of protection conferred by a European patent, due account shall be taken of any element which is equivalent to an element specified in the claims.

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which was presented by Bismarck to the Reichstag des Norddeutschen Bundes in 1868. Almost the same arguments are used today in the discussion on the protection of software patents.

3 Which can e.g. be used as means to protect the soil from pollution under a runway of an airport.

4 Which can e.g. be used to safely dispense an extremely toxic gas necessary for the production of integrated circuits.

5 Like "Sildenafil" in Pfizer's "Viagra".

6 Sec. 14 PatG; Art. 69 EPC.

7 Art. 164 Para 2 EPC.

III. The patentee may claim an injunction against any party using a patented invention to cease and desist from such use.[8]

Furthermore the patentee may claim compensation for damages,[9] destruction of infringing products[10] and even the recall of infringing products and their final removal from all distribution channels.[11]

IV. Thus, the patentee may use patents e.g.

- to protect own products, processes or uses
- as blocking means against products, processes and uses by third parties
- as means to generate license fees
- as means to negotiate cross licenses in case that own products, processes or uses make use of third party patents
- as a compilation of state of the art to be used in oppositions or nullity actions against (younger) third party patents or patent applications, which might be infringed by own products, processes or uses

C. Harmonization

International trade leads to the need of harmonization. Without harmonization decisions deviating from other decisions related to the same invention by national Patent Offices or related to the same invention protected by several patents in several countries by national Courts are unavoidable.

I. Status of harmonization

Over many years countries throughout the world have entered into agreements in the intellectual property field.[12]

1. The protection gained by a national patent is limited to the territory of the granting country. However, since 1883, apart from a few exceptions, most countries have been linked together by the repeatedly revised Paris Convention (ParC). The ParC facilitates obtaining patent protection in the convention countries in that, priority may be claimed from the first application filed in a convention country, so that its owner may file patent applications for the same invention within twelve months from the priority date in other convention countries. Relevant disclosures arising in the twelve months priority period are not taken into account for the decision on the grant of patents based on the later filed applications.

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8 Sec. 139 Subsec. 1 PatG.

9 Sec. 139 Subsec. 2 PatG.

10 Sec. 140a Subsec. 1, 2 PatG.

11 Sec. 140a Subsec. 3 PatG.

12 See for details: Gruber/Adam/Haber, *Europäisches und Internationales Patentrecht, Einführung zum EPÜ und PCT* (6th ed. 2008).

2. The problem of individual patent applications needing to be filed in each country in the respective national languages and having to observe the respective, quite different, national application requirements is addressed by the Patent Cooperation Treaty (PCT) of 1970. This is a special agreement within the terms of Art. 19 of the ParC. Under the PCT, the filing of a single international application complying with the PCT regulations has the same effect in each of the Designated States as a national application filed in those states in accordance with the national regulations and having the filing date of an international application. Designated States are the states designated in the application by the PCT applicant as those states in which he desires to have patent protection for his invention. After an international search and publication of the application and, if requested, a preliminary examination, the granting procedures themselves are carried out in the individual Designated States or regional patent offices in accordance with national or regional patent rules.

3. The European Patent Convention (EPC) of 1973 is a further special agreement within the terms of Art. 19 of the ParC; it also is a regional patent treaty under Art. 45 of the PCT. In each of the Contracting States designated in it, a valid European patent application also has the equivalent effect of a regular national application. After substantive examination as to the patentability of the invention for which the application is made, a European patent is granted by the European Patent Office (EPO) for all of the designated Contracting States. In so far as the EPC contains no contrary provisions with respect to minimum protection, these European patents have the same effect and are subject to the same regulations as national patents in all of the respective Contracting States. For the EPC Contracting States, European patents and applications are, in some respects, governed by supranational EPC standards of protection, such as minimum protection after publication,[13] protection for the product of a patented process,[14] scope of protection[15] and permitted grounds for national revocation.[16]

4. The TRIPs Agreement of 1995 is part of an agreement between states, namely the GATT, which is to be seen quite separately from the ParC. This agreement not only provides, as is standard in international agreements, for the treatment of foreigners in the same way as nationals,[17] but in addition, also provides for a most favourable terms provisions clause,[18] although, in this case, privileges of earlier agreements between countries, for instance the PCT, are not necessarily passed on. In Art 33 TRIPs it is recommended that the patent lifetime be twenty years from filing. In the USA, where patents previously ran for seventeen years from grant, this has resulted in the lifetime being changed to twenty years from filing.

5. The Community Patent Convention (CPC) of 1975/1989, which never came into force, is not a supranational act of legislation of the EC, but an agreement between the EC member states. The CPC aimed at allowing a uniformly valid EC patent to develop

13 Art. 67 Para 2 EPC.
14 Art. 64 Para 2 EPC.
15 Art. 69 EPC.
16 Art. 138 EPC.
17 Art. 3 TRIPs.
18 Art. 4 TRIPs.

out of the granting procedure of the EPC, in place of a bundle of patents, with a uniform law on infringement. The CPC has brought about extensive harmonization of national infringement conditions (e.g. in Germany, the UK and France). Substantive patent law was not in discussion. The Convention mainly failed because in some countries major concerns arose that there are constitutional impediments to give up authority to international bodies.

6. In 2001 the EC Commission submitted a draft for a Regulation for a Community Patent. It provided that the patent, once it has been granted by the EPO in one of its procedural languages (English, German or French), and published in that language, with a translation of the claims into the two other procedural languages, will be valid without any further translation. The proposal aimed to achieve a remarkable reduction in translation costs. The draft also contained the proposal to establish a Court having exclusive jurisdiction to invalidate issued patents.

After the Community Patent failed in 2004, the EC-Commission supported the European Patent Litigation Agreement (EPLA). This draft was created within the framework of the EPC. A number of Member States considered that the jurisdictional system and the Community Patent should form a package. Therefore, the EC-Commission currently follows this approach and negotiates both a modified Community Patent and a modified patent enforcement regime on the basis of the EPLA draft.[19]

Again there is almost no dispute on substantive patent law provisions. Main areas of disputes are the question of languages and translations, which is extremely important as to the costs for industry, and the question of the Court system.[20]

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[19] The patent enforcement regime includes a European Union Patent Court with a Court of First Instance and a Court of Appeal. Decisions of the Court of Appeal may be reviewed by the Court of Justice of The European Communities. The Court of First Instance will have local, regional and a central division. Local divisions will be competent for a Member State requesting a local division. Several Member States can also jointly request a regional division. Cases in Member States having neither a local or regional division are heard before the Central Division. Moreover, the Parties can agree to bring an action before any division, including the Central Division. With respect to the Community Patent the language regime is heavily discussed. The Commission introduced the proposal of only having machine translations. This would reduce costs significantly. Interested parties may nonetheless have a first idea of the protected technology and may decide on that basis, whether they want to invest in an accurate professional translation. It has to be noted that many practitioners already work in foreign languages as under the regime of the EPC only the original text is decisive. Accurate translations are less important. However, the idea of machine translations might be able to overcome the political insistence on translations in the patent field.

[20] I.e. the degree of centralisation, the institution of technical judges, and the representation in Court by lawyers only or also by patent attorneys, the languages to be used in the proceedings, the institution of local and regional entities of a centralized Court and their functions.

II. Deviating practice

The overview shows that there is already a remarkable degree of harmonization. E.g. European Patents have to be interpreted by all Courts of all member states according to the same provision, i.e. Art. 69 of the EPC. Anyhow, there are still deviating decisions as the Courts interpret Art. 69 of the EPC in a different way.

E.g. in Germany, a two-step method is used: In the first step (interpretation) the content of the patent claim is determined. In the second step the extent of protection is determined with the inclusion of equivalence. In Great Britain a single step, functional interpretation – purposive construction – is valid. These differences may lead and led to deviating decisions.[21]

D. No Harmonization – Competition of Systems of Law

I. Substantive law

Apart from the almost complete harmonization of substantive patent law some more "political" areas have been disputed or are still disputed. They relate to the question of patentability. Just as an example I refer to

- the protection of biotechnological inventions
- the protection of software

1. The protection of biotechnological inventions was disputed. A draft Directive on the Protection of Biotechnological Inventions from 1988[22] was defeated in the European Parliament, but was taken up again in a new Directive proposal in 1995 and then in July 1998[23] was passed by the European Parliament. This proposal for a Directive has had preliminary effects, in that the EPC has been brought into conformity with the Directive.[24]

Despite the Directive being existent there are still differences. These differences especially relate to the protection of the human body and its elements, especially the protection of a sequence or partial sequence of a gene.

The EPC provides in conformity with the Directive that a sequence or partial sequence of a gene may constitute a patentable invention. However, the industrial application of a sequence or partial sequence of a gene must precisely be disclosed in the patent application.[25] German law provides for a narrower approach. The industrial application

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[21] In the famous "*Epilady*" *cases* related to an apparatus (to be mainly used by women) to remove hair from the body, the question at stake, was, whether a device with a "slotted rubber lip" infringes a patented device with a "coiled helix". The German Courts confirmed an infringement in the main action, whereas the British Courts denied the infringement. Similarly the Courts in the Netherlands confirmed the infringement, whereas the Austrian Courts denied the infringement.

[22] COM/1988/496/Final, OJL C10/3 of 13 January 1989.

[23] Directive 98/44/EC of 6 July 1998, OJL 213/13 of 30 July 1998.

[24] This happened despite the fact that the EPO is not bound by an EC-Directive.

[25] Rule 29 to the EPC.

of a sequence or partial sequence of a gene has not only to be precisely described in the patent application but moreover has to be included in the patent claim.[26]

Apart from the question if Germany by its said law is still in compliance with the obligation to implement the Directive, the more restrictive approach for the patentability of a sequence or partial sequence of a gene will lead to the result that applicants, in this respect, will rather file European patent applications than national patent applications.

2. Software can not be protected by a patent as, in principle, programs for Computers are not regarded as inventions.[27]

Software protection was covered by Copyright law and harmonized by the Directive on the Protection of Software of 1991[28]; since implemented in Germany in §§ 69 a seq. of the German Copyright Act (Urhebergesetz -UrhG) and enacted in the UK as the Copyrights (Computer Programs) regulations 1992.

A draft Software Patents Directive[29] has been rejected by the European Parliament in 2005.[30]

Nevertheless it is said that about 30.000 European software patents have already been granted. The Open Source Community argues that such granting is against the law. However, Sec. 1 of the PatG and Art. 52 of the EPC only exclude software as such from the patentability. Software included in a product may be patented (e.g. the control for a nuclear power plant).

Thus, the legislation on software patents is harmonized within the EC, even though the national Patent Offices and the national Courts in practice differ on the question whether a patent application relates to software as such and thus has to be rejected or whether a patent application is related to a product including software, which may be protected by a patent.

II. Legal consequences

The legal consequences are dealt with by national law. This is self-evident for national patents. Moreover Art. 64 Para 3 of the EPC provides for national law to deal with any infringement of a European Patent.

There is no dispute that the patentee can claim an injunction against an infringer.[31]

There is further no dispute that the patentee has a claim for damages resulting from a patent infringement. However, the concepts of damages are very different. E.g. German law does not provide for punitive damages or treble damages like US law. Under German law the patentee may choose between 3 calculation methods to claim damages:

- damages according to a reasonable license
- damages amounting to the profit of the infringer
- damages according to the patentee's own profit

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26 Sec. 1a PatG.

27 Sec. 1, Subsec. 3, No. 3 PatG; Art. 52, Para 2 lit. c) EPC.

28 Directive 91/250/EEC, OJL 122/42 of 17 May 1991.

29 COM/2002/92/Final, OJC 151E/129 of 25 June 2002.

30 OJC 157E/265 of 6 July 2006.

31 E.g. Sec. 139 Subsec. 1 PatG.

From my experience as patent litigator 90 % of the cases for damages are settled on the basis of a reasonable license because the two other methods involve major problems in proving the infringer's profits or own lost profits. The calculation according to the infringer's profits has flourished recently as the German Federal Court of Justice held[32] that the infringer must not deduct overheads in calculating his profits, but may only deduct costs directly attributable to the infringing product. This decision led to a fictitious profit which amounted to up to 65% of the turnover.[33] Meanwhile there is a drawback, as the Federal Court of Justice held[34] that "only" the part of the profit, which is caused by the infringement, can be claimed.

German law has very often been criticised in the past by foreign lawyers as inviting patent infringers because of the concept of damages.

Within the EC the legal consequences have been harmonized by the Directive 2004/48 EC "on the Enforcement of Intellectual Property Rights".[35] As to damages Art. 13 of the Directive states

> 1. Member States shall ensure that the competent judicial authorities, on application of the injured party, order the infringer who knowingly, or with reasonable grounds to know, engaged in an infringing activity, to pay the right holder damages appropriate to the actual prejudice suffered by him/her as a result of the infringement.
>
> When the judicial authorities set the damages:
>
> (a) they shall take into account all appropriate aspects, such as the negative economic consequences, including lost profits, which the injured party has suffered, any unfair profits made by the infringer and, in appropriate cases, elements other than economic factors, such as the moral prejudice caused to the right holder by the infringement;
>
> or
>
> (b) as an alternative to (a), they may, in appropriate cases, set the damages as a lump sum on the basis of elements such as at least the amount of royalties or fees which would have been due if the infringer had requested authorisation to use the intellectual property right in question.

This provision implies that several aspects have to be taken into account to calculate a well-balanced and adequate compensation. This differs from the German approach.

III. Fact finding

The concepts of fact finding are very different in several countries. The different concepts range from pre-trial discovery (US) to Anton-Pillar-Order (UK) to Saisie (France, Italy) to no-fishing expedition (Germany).

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32 BGH 2 November 2000, GRUR 2001, 329 "Gemeinkostenanteil".

33 See Rojahn, *Praktische Probleme bei der Abwicklung der Rechtsfolgen einer Patentverletzung*, GRUR 2005, 623.

34 BGH 6 October 2005, GRUR 2006, 419 "Noblesse".

35 OJL 195/16 of 2 June 2004.

1. However, especially in Germany the legal approach has been changed dramatically during the last years under international influence and obligations.

If an assumed infringing device is not available on the market an inspection of the device at the defendant or at a third party is necessary to establish whether or not there is a patent infringement. According to Sec. 809 of the German Civil Code (BGB) there is a claim for inspection if a person "has a claim in respect of a thing against its possessor or wishes to obtain certainty as to whether he has such a claim". Under the principle of no-fishing expedition the Federal Court of Justice held before 2002 that the patentee has to establish a very high probability of infringement to be allowed to inspect a device. Further, the inspection was very limited. It did not include the installation or the removal of components of the infringing device.[36]

In 2002 the Federal Court of Justice changed the approach in the decision "Faxkarte".[37] In this decision the Court held that it is not necessary to establish a very high probability of infringement. The Court only required a "certain" probability of infringement for a claim of inspection. The inspection then was not limited but included e.g. the analysis of a source code.

Based on the precedence of the Federal Court of Justice and the TRIPs-agreement and the Enforcement Directive (at that time still to be implemented by Germany) the Duesseldorf Courts developed an inspection proceeding which is based on the independent proceedings for the taking of evidence.[38] The independent proceedings for the taking of evidence can be combined with a preliminary injunction for the toleration of the measures as instructed by the Court for the inspection of the device.[39] The Duesseldorf Courts allow the inspection of an asserted infringing device if the patentee proves a certain probability of a patent infringement. This practice in fact sets aside the prior principle of no-fishing expedition under international influence and obligations.

2. The Enforcement Directive harmonizes the fact finding aspects for the EC in its Art. 7. The German Implementation Act, which has been enacted belatedly,[40] complies with Art. 7 by an amendment of Sec. 140 c of the PatG. However, the wording of Art. 7 of the Enforcement Directive and correspondingly of Sec. 140 c of the PatG is quite general so that it is open if the proceedings as developed by the Duesseldorf Courts will also be applied by the other German Courts having jurisdiction in patent infringement matters or if the details will remain different in the future, especially as the proceedings as developed by the Duesseldorf Courts are disputed, because they may lead to severe problems in the protection of business secrets of the potential patent infringer.

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36 BGH 8 January 1985, GRUR 1985, 512 "Druckbalken".

37 BGH 2 May 2002, GRUR 2002, 1046 "Faxkarte".

38 Sec. 485 Seq. of the German Code of Civil Procedure (ZPO).

39 For a detailed overview on the proceedings: see Kühnen, Die Besichtigung im Patentrecht, eine Bestandsaufnahme zwei Jahre nach „Faxkarte", GRUR 2005, 185.

40 Effective as per 1 September 2008.

E. Investment factor?

Being a patent litigator I have no direct knowledge of investment decisions of companies in their countries of sale.

1. However, I think one can learn about investment decisions of companies in their countries of sale indirectly by reviewing some statistics on national patent applications in Germany and European patent applications.[41]

In 2006 approximately 60.000 national patent applications were filed in Germany, 48.000 from Germany, 3000 from European countries, 8000 from non-European countries (3.500 from Japan, 2700 from the USA, 750 from Korea, 500 from Taiwan).

In the same year 2006 approximately 135.000 European patent applications were filed. 65.600 applications were filed from EC-Countries and 69.500 from Non EC-Countries. Most applications from EC-Countries were filed from Germany (24.800), France (8.000), the Netherlands (7.300), United Kingdom (4.700) and Italy (4.200). The Non-EC-Countries applications divide into: USA 34.800, Japan 22.100, Switzerland 5.400, Korea 4.500, Canada 2.000 and Taiwan 750.

These statistics show that the German and European Patent systems are apparently widely used from companies doing business in Germany and the European Union.

2. Moreover the number of patent infringement cases handled by the Courts within the EC confirms that companies make use of existing patent systems.

There are no published statistics on patent litigation activities at EC-member-state level. However, the EC-Commission states[42] that it can be established from available information that for 2003 to 2006 an average of 1.500 to 2.000 patent infringement and invalidity actions were brought before first instance patent tribunals of which 60 to 70% concerned European patents. 90% of current patent litigation in the EC takes place before the tribunals of just 4 member states (Germany, France, UK and the Netherlands).

I know from my experience that approximately 600 patent infringement actions are filed per year with the Regional Court in Düsseldorf (Landgericht Düsseldorf). It is said that as to the number of cases the tribunals deciding patent infringement cases in Paris, Mannheim, Munich, Lyon, Den Haag and London are the following.

3. The cited statistics and the view of the EC Commission match with my professional experience.

I handled and I am handling a great number of patent infringement cases in Germany, which were or are part of an international dispute with patent infringement cases in several jurisdictions. This demonstrates that companies are using existing patent law systems to pursue their interests and that companies are prepared to spend quite remarkable amounts of money to do so.

Moreover I realize that an increasing number of companies from countries getting more and more industrialised, e.g. from China, apply for patent protection in Germany

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41 See for any details: „Statistik des Deutschen Patent- und Markenamtes für das Jahr 2006", Blatt für Patent-, Muster- und Zeichenwesen 2007, 104 et seq; Annual Report 2006 of the European Patent Office.

42 Communication from the Commission to the European Parliament and the Counsel, Enhancing the Patent System in Europe, COM/2007/165 final.

and the EC and use their patents against patent infringers from whatever country including China and Taiwan. This demonstrates that apparently companies making their own inventions and being active in international trade use existing patent law systems to protect their interests.

Just an example for an investment from a small entity because of patent law: My law firm located in Munich decided to establish an office in Düsseldorf in 1998 because of the predominant position of the Regional Court in Düsseldorf in patent infringement litigation.

4. My professional experience also matches with a contribution during the Symposium that there are 3 factors for investment decisions:

- Access to markets
- Legal environment
- Tax aspects

On the other hand I shared some experience as stated during the Symposium that investments can also be mainly

- market driven
- cost driven

and may be almost independent from the existence of a patent law system.

One reason for a company to be prepared to accept the risk that there is no remedy against a copying of a patent can be that a patent application has to contain an enabling disclosure on the one hand, but that it is not necessary that the patent application discloses the know-how for the industrial applicability of the invention on the other hand.

F. My conclusions

My conclusion is that a patent law system is appreciated and used by companies active in international trade to protect and pursue their interests in their countries for sale.

Companies might be prepared to invest in a country despite of a non-existing or non-effective patent law system, in case that the expected advantage of market chances or reduction of costs prevails over the potential risk that there is no remedy that inventions are copied.

Companies may be prepared to run the risk that an invention is copied because the patent does not necessarily disclose the know-how for an industrial production, which may be kept as a business secret.

Worldwide Trademark Management

Rembert Niebel[*]

Volker Jänich has highlighted in his paper that IP rights do not generally have much influence on the choice of the location of investment. At least in the area of technical inventions and copyright, the territoriality principle and the principles of national treatment and non-discrimination provide a level playing field across national borders. As a result, businesses will accord not too much weight to the IP regime in a given jurisdiction when making their investment decisions.[1]

As trademark law cannot lay claim to a fundamental function in influencing investment choices, either, this paper will explore in some depth how the main features of the regulatory environment in the area of trademarks drive the choices businesses are making. Also, this paper will explore whether international harmonization of trademark laws so far has resulted in a regime that provides maximum benefit to businesses and consumers.

A. The Enabling Role of Trademark Law

While trademark law is a relatively recent area tracing its roots back to the industrial revolution and the evolution of liberal economic constitutions in the 19th century,[2] there has always been a need for consumers to distinguish between goods of different origins, and for businesses to signify the origin of their products by marking them. Even in early times, craftsmen marked their products with individual signs, such as the stonemasons in Ancient Egypt marking the blocks of stone they provided for the pyramids. Furthermore, manufacturers and consumers attributed notions of particular quality to certain designations of origin, such as Egyptian cotton, Bavarian beer or prosciutto di Parma.

However, *legal* protection of such marks was not universally recognized until modern nation states with liberal economic regimes evolved and until efficient manufacturing processes and the division of labor created a much broader spectrum of manufacturers and products, resulting in a greater need for means to distinguish between them. In particular, the idea of vesting property-like rights to the owner of a trademark is a fairly recent idea. Trademarks as such enjoy no "original" form of protection, such as at least certain technical inventions which may be kept secret rather than obtaining patent protection for them. Trademarks have no use unless they are used in commerce, and when they are used in commerce and have generated good-will, reputation and value, they will attract

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1 V. Jänich, *The Territorial Dimension of Intellectual Property Law*, p. 211 et. seq.

2 See, e.g., Fezer, *Markenrecht* (3rd ed. 2001) Einl. MarkenG para. 1 et seq.

imitation. Without a legal regime granting some form of protection, trademark users would be at the mercy of their competitors who could use their valuable marks at will.

Today, it is clear that this would be an unacceptable result, both from a consumer protection perspective and as poor economic policy. If no trademark protection existed, consumers would be subject to constant deceptive marketing, with competitors using identical or confusingly similar trademarks. Furthermore, this would provide a disincentive for companies to market quality and innovative products, as they would have no means of safely communicating these notions of product quality to consumers, be they inherent or acquired. Furthermore, disenfranchising businesses from the ownership of trademarks in which they have invested and in which value has accrued would be problematic from a property-rights perspective.[3]

It is therefore not surprising that common law jurisdictions soon accorded protection to trademarks that were used in commerce, even if at least initially under application of unfair competition theories.[4] In civil law jurisdictions, the 19th century saw the enactment of trademark statutes, which required that, in order to obtain protection, trademarks had to be registered on a public register.[5]

While differences between common law and civil law trademark systems continue to exist, trademark protection today is a worldwide reality. Certainly, the existence of trademark protection is a prerequisite for a company to make a certain kind of investment decision, namely, whether or not to market a product under a valuable trademark in a given jurisdiction, and whether to invest in the marketing of a product.

B. Global Marketing Strategies and National Trademark Protection

Today's businesses are facing global markets and global competition. While the evolution of national trademark laws has been driven by economic policy, business needs and consideration for consumer protection, businesses today need a global trademark protection system which gives them certainty that their marks will be registered and that at least a minimum standard of effective protection is afforded, such as protection against third party use of similar trademarks for similar products.

From businesses' perspective, the importance of trademarks for product marketing has increased,[6] and nowadays market participants consider trademarks as an important, often the most important, equity of their business.[7] However, this does not mean that they accord particular importance to the legal aspects of trademark protection. Branding a product is primarily a marketing decision, and much less a legal one.

Viewed from a marketing perspective, trademarks are used by businesses to identify the source of the good and communicate notions of quality, reputation and image of its

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3 Even if recently the property rights justification for IP protection has been drawn into doubt, cf., e.g., L. Lessig, *The Future of Ideas* (2001) at 204 et seq. and *passim*.

4 Cf. Restatement of the Law (Third), Unfair Competition, § 1 (a) (2).

5 For Continental Europe, see Coing, *Europäisches Privatrecht*, Bd. II, S. 168 ff.

6 Cp. Meffert, Heribert/Burmann, Christoph/Koers, Martin (eds.), *Markenmanagement: Grundfragen der identitätsorientierten Markenführung* (2002) pp. 101 f.

7 Meffert, Heribert/Burmann, Christoph/Koers, Martin (eds.), *Markenmanagement: Grundfragen der identitätsorientierten Markenführung* (2002) pp. 4 f.

source to find and bind customers for the offered good.[8] The investment in a mark is driven by this goal, and it dominates the focus of the marketing people who coin trademarks. In marketing theory, the main aspects considered when developing a trademark are the memorability, meaningfulness, likeability, transferability, adaptability, and finally protectability of a mark.[9] In other words, the legal protectability of the mark is just one aspect of many.[10] Interestingly, a survey among managers about branding decisions shows that legal questions, like the ability to protect a trademark, have a significance of only 9% in a branding decision.[11]

This, to some extent, is also a result of the modern organization of a business. Branding is a task performed by marketing managers, external branding and advertising agencies or, in small businesses, by the business owners, all of whom usually have little detailed understanding of trademark law. Usually this aspect is taken into account only as last step in the decision process when, on a legal plane, the availability of the trademark and its protectability are evaluated.[12] This is performed most of the time by staff in the patent or IP department of the company or external lawyers or patent agents. At this stage, marketing people obtain input whether there are prior rights in a particular jurisdiction that may prevent them from using a chosen trademark, and they may also obtain input as to whether the trademark can likely be registered in a particular jurisdiction. While at this stage sometimes new trademarks have to be chosen because a trademark may be unavailable for use in a given jurisdiction due to third party prior rights, it is relatively rare that an alternative trademark is chosen just because a particular trademark cannot achieve registration in a particular country, such as, for example, because it is not considered distinctive.[13] In fact, when a company chooses in which country to use a trademark with regard to a particular product, this is a decision that is almost entirely driven by the product market and the competitive situation in a country rather than by an evaluation of the trademark law[14] in a given market.[15] In sum, the brand's value as equity results

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8 Meffert, Heribert/Burmann, Christoph/Koers, Martin (eds.), *Markenmanagement: Grundfragen der identitätsorientierten Markenführung* (2002) p. 6.; a summary of the various marketing functions of trademarks can be found in J. Bröcher/M.-L. Hoffmann/T. Sabel, *Dogmatische Grundlagen des Markenrechts* (2005) p. 8 et seq.

9 Keller, Kevin Lane, *Strategic branding management: building, measuring, and managing brand equity* (2nd ed., 2003) pp. 174 ff.

10 Keller, Kevin Lane, *Strategic branding management: building, measuring, and managing brand equity* (2nd ed., 2003) p. 180.

11 Esch, Franz-Rudolf, *Strategie und Technik der Markenführung* (2nd ed., 2004) pp. 218 (fig. 139), 219 f.

12 Esch, Franz-Rudolf, *Strategie und Technik der Markenführung* (2nd ed., 2004) pp. 217, 220, 225; Keller, Kevin Lane, *Strategic branding management: building, measuring, and managing brand equity* (2nd ed., 2003) pp. 175, 180, 190 (fig. 4-6).

13 For example, in some jurisdictions, trademarks which primarily function as a family name cannot be registered. Also, a trademark that is considered distinctive in one jurisdiction may be descriptive in another. For a practical example, see ECJ, Case C-421/06 – MATRATZEN/Matratzen.

14 More information on the considerations of an international trademark management: Keller, Kevin Lane, *Strategic branding management: building, measuring, and managing brand equity* (2nd ed., 2003) chap. 14.

15 Esch, Franz-Rudolf, *Strategie und Technik der Markenführung* (2nd ed., 2004) p. 225.

from its marketing function, and its legal protectability is "only" one premise to secure the added value.[16]

Furthermore, before investing into new markets, most brand managers will carefully consider whether a unitary global brand or local branding fits best to reach the business objectives.[17] While most marketing departments will take significant care to choose trademarks that fit best the cultural background in those countries where the products or services are on offer, most decision makers in marketing have a strong preference for using a unitary trademark strategy under which a particular good will be offered under one and the same brand name around the world.[18] This has the advantage of synergy effects by compounding the impact on the global market and by realizing savings for unitary marketing campaigns.[19]

In summary, it appears that in a globalized economy, businesses seem to assume that sufficient trademark protection is available (almost) globally and, as a result, they lay emphasis on optimizing their branding and marketing strategies. To some extent, in doing so, they underestimate differences between trademark laws as they continue to exist. However, before we explore some of these differences, we will see how trademark law has anticipated the globalization of economies and marketing strategies.

C. The Globalization and Harmonization of Trademark Law

For over a century, and thus long before the term "globalization" was coined, the area of trademark protection has seen legislators and the IP community rush towards the harmonization of IP and, in particular, trademark laws. Competition of IP systems has generally been limited, as a result of territoriality, to niches such as transnational IP enforcement and IP registration where supra-national and national registration regimes overlap, such as in case of the Community trademark. This has led to comparable standards of protection in most countries, further reducing the importance of trademark law for localizing investment decisions.

From the late 19th century, individual ownership of trademarks has been available in virtually all industrializing and industrialized countries, and, today, practically all developing nations also operate trademark systems that at least meet basic standards in attributing exclusive individual ownership to the registered owner of a trademark. Beginning with the Paris Convention,[20] signed in 1883, and certainly not ending with the adoption

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16 Cp. Meffert, Heribert/Burmann, Christoph/Koers, Martin (eds.), *Markenmanagement: Grundfragen der identitätsorientierten Markenführung* (2002) 461.

17 Keller, Kevin Lane, *Strategic branding management: building, measuring, and managing brand equity*, 2nd ed., 2003, p. 689; Meffert, Heribert/Burmann, Christoph/Koers, Martin (eds.), *Markenmanagement: Grundfragen der identitätsorientierten Markenführung* (2002) pp. 159 ff.

18 Meffert, Heribert/Burmann, Christoph/Koers, Martin (eds.), *Markenmanagement: Grundfragen der identitätsorientierten Markenführung* (2002) pp. 159 f.

19 Keller, Kevin Lane, *Strategic branding management: building, measuring, and managing brand equity* (2nd ed., 2003) pp. 683 ff.

20 *Paris Convention for the Protection of Industrial Property*, signed in Paris, France, on 20 March 1883.

of TRIPs[21] in 1994 and the Singapore Treaty[22] in 2006, governments have been keen to enable trademark owners around the world to acquire trademarks economically and to provide protection at a sufficient level. Even in the early stages of industrial development, nations did not see a major advantage in fostering larger local discrepancies in trademark law because they realized that the notions of national and reciprocal treatment would enable their own nationals to do business and compete in other countries.

Therefore, in many respects, a minimum level of protection is now not only the accepted norm across the world, but also mandated by numerous international legal instruments. These include the 1883 Paris Convention which provides for national treatment, rights of priority on the basis of a prior foreign trademark filing, and certain minimum standards on protection and procedure. Some other instruments have more narrowly focused on the international harmonization of trademark filing regimes, like the 1957 Nice Convention,[23] the 1994 Trademark Law Treaty[24] and the 2006 Singapore Treaty. The TRIPs Agreement has brought significant harmonization with respect to trade-related aspects of trademark laws. Harmonization has also been significantly driven by the international legal instruments that provide for central filing regimes, like the 1891 Madrid Agreement and the 1989 Madrid Protocol to the Madrid Agreement. Even closer integration can be seen in unitary transnational instruments like the Benelux trademark and the Community trademark.

Finally, companies that consider an investment in a trademark for a certain country have no real options from which to choose. They will have to deal with the national legal system. And even where different regimes offer a parallel trademark existence, companies do not have a real choice. In the EU one can select between a national trademark registration and a Community trademark registration. But finally both offer more or less the same quality of protection.[25] The reason for this situation is that the legislator has chosen to restrict competition by harmonizing national laws before implementing the supra-national system. From the trademark owners' perspective, the choice between different regimes of obtaining trademark protection is usually viewed as being a matter of economy and, to some extent, as a function of the ability of the system to afford them with the protection desired.

The current status quo has led to a situation where trademark owners do not have to worry too much about local idiosyncrasies in trademark law. In significant parts of the world, trademark protection can now be obtained by filing one central application, such as for a Community trademark or an International application covering the member states of the Madrid Agreement and the Madrid Protocol. Local differences do not play a major role. While the trademark owner has to ensure that her trademark is distinctive and that she does not infringe prior rights, and while trademark applications are more

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21 *Agreement on Trade Related Aspects of Intellectual Property Rights* (TRIPs), negotiated at the General Agreement on Tariffs and Trade (GATT) in 1994.

22 *Singapore Treaty on the Law of Trademarks*, adopted by the World Intellectual Property Organization (WIPO) in Singapore, on 27 March 2006.

23 *Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks*, of 15 June 1957 at Nice, France.

24 *Trademark Law Treaty* adopted at Geneva, Switzerland, on 27 October 1994.

25 Detailed comparison of national and Community trademarks: Rohnke, Christian, "Gemeinschaftsmarken oder nationale Marken? – Strategische Überlegungen zur Rechtsdurchsetzung", GRUR Int., 2002, pp. 979-989.

cumbersome or costly to prosecute in some countries than others, today's worldwide trademark practice does not show glaring gaps on the global map. As trademark protection is a commodity, and as national differences do not play a major role, trademarks are usually no major factor in locating investments.

D. Exceptions to the Rule

In some cases, of course, the exception has to confirm the rule. Harmonization of substantive trademark laws has not led to a uniform trademark practice globally, of course.

As a result, some fairly significant differences continue to exist, for example, in the area of according protection to certain types of trademarks, such as "suggestive" word marks and "non-traditional" trademarks, such as three-dimensional trademarks, color marks, sound marks and the like. For example, under Federal U.S. trademark law, trademarks consisting just of color ("color *per se*" marks) cannot be registered on the Principal Register (and thus acquire full protection) unless they have acquired secondary meaning.[26] In contrast, color marks in the EU can be found inherently distinctive and thus registrable without a showing of secondary meaning if the relevant customer circles can be shown to recognize color as a designation of origin due to the specific circumstances in that market.[27] This situation creates a major difference to a business relying on color as a primary trademark, and can, of course, influence its marketing strategy considerably. It is unlikely, though, that a company would decide not to market its products in the U.S. just because its color mark has not acquired secondary meaning there yet.

Also, exhaustion of rights rules can influence investment decisions to a considerable extent. The concept of the exhaustion of trademark rights means that the owner cannot invoke her rights in the trademark against the sale of a product bearing the trademark once the marked product has been put on the market by the trademark owner or with her consent.[28] The most important question in this regard is whether the exhaustion doctrine is applied as a national, regional or worldwide principle. If the first sale of the marked product exhausts the trademark rights just nationally or regionally (such as in the EU), then the trademark owner can prevent unauthorized parallel imports from territories outside the area where the trademark rights have been exhausted. This rule is of interest for companies that try to maintain different price levels or try to market products in different versions or forms in different countries. The prevention of parallel imports enables them to divide up the markets and implement different branding, product, pricing and

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26 *Wal-Mart Stores, Inc. v. Samara Brothers, Inc.*, 529 U.S. 205, 211-212, 54 USPQ2d 1065, 1068 (2000).

27 ECJ, Case C-104/01 – Libertel.

28 Detailed international view on the rule of exhaustion and its consequences for parallel imports: Gallego, Gonde, *The Principle of Exhaustion of Rights and Its Implications for Competition Law*, IIC, 2003, pp. 473-502; Jehoram, Cohen, *International exhaustion versus Importation Right: a Murky Area of Intellectual Property Law*, GRUR Int., 1996, pp. 280-284.

marketing strategies in each area which applies national and regional exhaustion rules, such as in the EU where a doctrine of EU/EEA-wide exhaustion applies.[29]

Obviously, this rule will influence product, pricing and marketing strategies. Trademark owners know that they cannot prevent the free circulation of goods put into commerce in the EU/EEA, but they can, for example, choose to discontinue the sale of outdated products in the EU/EEA, withdraw remaining quantities from those markets and export them to, for example, Russia, and sell them at a low price there, without having to fear that those goods will be re-imported from Russia to the EU where the next product generation may already be on sale.

Also, to some extent, different levels of the enforcement of trademark rights and weaknesses in trademark protection may direct companies to set up production in countries with stronger enforcement mechanisms than others. Nevertheless, most producers of consumer goods have still decided to set up production facilities in China, a country where protection is available and where trademark enforcement can be made to work, but where the sheer volume of counterfeiting activities is so large that many owners find it very difficult or impossible to control the level of infringement.

E. Territoriality, Universality, Harmonization

Is this the best of all (trademark) worlds? Have the invisible hand and the genius of the trademark legislators together overcome the potential chaos in trademark protection that could have arisen as the result of territoriality, and have they, in doing so, provided well-balanced protection to trademark owners, consumers and other constituencies? Have they perfectly reconciled the interests of the business community in universal and unitary trademark protection with the need for taking into account of local languages and local economies? Hardly so. With global trademark counterfeiting reaching new superlatives by the day, with trade conflicts looming about the use of designations such as "Parmesan" cheese, with bitter disputes about the use of trademarks on the Internet in the face of national trademark protection, and with resistance against more universal substantive standards in trademark law, all is not well. Also, it may well be that the scope for improvement through harmonization has almost been exhausted. In the coming years, the efforts will be directed at adjusting upwards the standards of effective trademark protection, in particular against counterfeiters. There then may come a point when differences in effective trademark protection may no longer play a role in locating investments globally.

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[29] ECJ, Case C-355/96 – Silhouette/Hartlauer, at para. 31; the EU is unlikely to change that rule, see Commission Staff Working Paper on Possible Abuses of trademark rights within the EU in the context of Community exhaustion, May 21, 2003, SEC(2003)575.

Chapter 5
Competition Law

Competition as a WTO subject

Friedl Weiss[*]

A. Introduction

Competition concerns have been on the multilateral agenda for many years. Already during the ultimately abortive negotiations on the creation of an International Trade Organization (ITO) in the late 1940s, discussions of competition issues – prompted by the behaviour of German cartels and Japanese *zaibatsu*[1] in the pre-Second World War period – reflected concern that international cartels and restrictive business practices could block market access. Subsequent deliberations by the CONTRACTING PARTIES of the General Agreement on Tariffs and Trade (GATT) of the implications for competition of trade policies such as tariffs, antidumping duties, quotas and technical barriers to trade have a long pedigree, both in terms of policy discussion and economic analysis. Although they decided that it would not be practicable for them to undertake any form of control of such practices nor to provide for investigations[2] there was, nonetheless, agreement amongst them that the activities of international cartels and trusts may hamper the expansion of world trade and interfere with the objectives of the GATT.[3]

In the United Nations context intense and vivid discussions took place in the 1960s and 1970s on the need to discipline restrictive business practices by multinational enterprises.[4] In Europe, the provisions relating to rules governing competition of the Treaties establishing the European Coal and Steel Community and the European Economic Community respectively, as well as work done in this field by the Organisation for European Economic Cooperation (OECD) and by the Council of Europe reflected similar concerns. Renewed attention was focused on these issues in the 1980s, partly as a result of US concerns that restrictive practices in distribution and conglomerates in Japan (*keiretsu*)[5] nullified the expected benefits of negotiated trade liberalization. In the 1990s, concerns were voiced that "mega mergers" and abuse of dominance (monopolization) as

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1 The Japanese term *zaibatsu*, literally meaning "property", describes industrial and financial business conglomerates in the Empire of Japan. Existing from the 19th centuries, these conglomerates had a considerable influence on the Japanese economy within the Empire of Japan.

2 See the 5th pre-ambular paragraph of the Decision of 18 November 1960, BISD 9S/28.

3 See the preamble of the Resolution of 5 November 1958 containing the terms of reference of a Group of experts on restrictive business practices and their Report adopted on 2 June 1960, BISD 9S/170.

4 See the discussions in the Economic and Social Council of the UN and the reports of its Ad Hoc Committee.

5 The Japanese term *keiretsu* refers to a cooperation of a number of companies, characterised by interlocking business relationships and shareholdings.

exemplified by the Microsoft, Boeing-McDonnell Douglas, General Electric-Honeywell and Worldcom-Sprint cases could have anti-competitive effects and lead to disputes between competition authorities. More generally, the fact that competition policy played an important role in the creation of a European single market led to greater interest in exploring whether similar disciplines would be beneficial in the GATT/WTO context.[6]

Shortly after the completion of the Uruguay Round of multilateral trade negotiations in 1994, the contracting parties of the GATT agreed that the newly created World Trade Organization (WTO) should turn its attention to three new topics: (1) trade and labour, (2) trade and the environment; and (3) trade and competition. However, with regard to the topic of trade and competition consensus on how to proceed proved elusive. Some Members favoured immediate negotiation of a competition agreement while others, especially the United States, preferred that the topic be studied further (or indefinitely) before moving towards a binding agreement creating dispute settlement rights.

B. The Economics of Competition Policy

Any elementary summary of the economics of competition rules must address at least two questions: why are competition rules needed and which goals do they serve?[7]

Competition policies reflect the basic idea that monopolies, representing the most extreme form of market power, are "bad" because they cause both static inefficiency and, due to monopoly pricing, damaging welfare loss. A monopoly might also lead to productive and dynamic inefficiencies. Monopolies are sheltered from competition, being immune to pressures to adopt the most efficient technologies and to invest much in research and development. As a result they tend to charge excessively high prices and possibly operate with costs which are too high, while innovating too little.

However, competition policy is not designed for the defence of competitors, for instance so as to increase their numbers – keeping less efficient firms artificially in business would lead to a distortion of the allocation of resources and to a reduction of economies of scale, entailing a reduction of welfare – but is concerned with defending market competition in order to increase welfare.[8]

As regards the question of the interaction between competition law and consumer protection, there are certain gaps between their respective objectives. Competition law is primarily concerned with economic efficiency and with the overall welfare of society, without distinguishing between different groups of society. The awareness of how the enforcement of competition law affects consumers is increasing, thereby leading to a concomitant increase in the implementation of consumer welfare standards. Consequently, competition law guarantees that consumers get a fair share of the economic benefits re-

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6 Bernard Hoekman, Petros C. Mavroidis, *Economic Development, Competition Policy, and the World Trade Organization,* Journal of World Trade 37 (2003), pp. 1-27, at 1 f.

7 On the interaction between competition and economic performance, see Bernard J. Philips, Jeremy West, *Competition, Innovation and Performance,* Conference Paper – Encore Annual Conference, 12 April 2007, The Hague (2007), available online at: http://www.encore.nl/conference2007/doc/paper%20phillips.pdf.

8 Massimo Motta, *Competition Policy – Theory and Practice* (Cambridge University Press, 2004) p. 39.

sulting from the efficient working of markets and from economic and technical progress. However, competitive markets do not always result in increased benefits for consumers. More competition does not automatically lead to more consumer welfare. Even in competitive markets consumers may still experience difficulties which are mainly due to information failures.[9]

Figures from UNCTAD show that *competition laws* were adopted in two developed countries after 1989 (bringing the total from 22 to 24), in 26 former communist countries (up from zero) and in 30 developing countries DCs (bringing the total from 10 to 40). Despite experiencing difficult challenges in the formulation and implementation of competition and consumer policies – attributable to a lack of adequate financial, material and skilled human resources – the number of DCs and LDCs adopting competition laws is likely to increase, due to pressures from the European Union, the World Bank and UNCTAD itself. It appears that countries accounting for, perhaps, 90 percent of world trade have already enacted *competition laws*.[10]

What is the reason for this pressure emanating from the organisations and institutions mentioned above? Is it their pressure or economic self-interest that prompted DCs to adopt them? In order to answer this question one should be aware that the agenda of international organisations is likely to be dominated by market access issues, at any rate more than by issues of international antitrust. That is to say that, typically, the interests of major producers in export markets prevail over the interests of the economy as a whole which would require the adoption of competition laws. Stated in a somewhat simplified manner: trade officials in exporting countries seek to force competition officials in importing countries to assist in opening markets. Seen from the perspective of bureaucratic politics, this can give rise to a conflict between competition or anti-monopoly authorities worldwide and trade officials. Thus, competition officials are concerned that their main objective – the defence of economic efficiency – may become subordinated to that of trade officials whose aim is to promote exports.[11] It should be noted, lastly, that a Group of Experts on Competition Law and Policy has recently underlined the importance of using economic analysis in competition cases.[12] Such focus on economic factors is also prominent in WTO law in which emphasis on the market has been recognised by panels as well as by the Appellate Body. For instance, in the *Japan – Taxes on Alcoholic Beverages* case the panel stated that "the appropriate test to define whether two products are 'like'

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9 Katalin Judit Cseres, *Competition Law and Consumer Protection* (Kluwer Law, 2005) p. 407.

10 Until May 2008, the UNCTAD secretariat has reproduced the competition laws of 52 countries, See the latest issue of the UNCTAD Handbook on Competition Legislation – Note by the UNCTAD Secretariat of 13 May 2008, TD/B/COM.2/CLP/64.

11 Bernard Hoekman, Peter Holmes, *Competition Policy, Developing Countries, and the World Trade Organization*, World Bank External Paper, p. 21, available online: http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/1999/11/19/000094946_99110505432934/additional/101501322_20041117155002.pdf.

12 See para. 4 of the Agreed conclusions adopted by the Intergovernmental Group of Experts on Competition Law and Policy on its ninth session (15-18 July 2008), UNCTAD, TD/b/COM.2/CLP/72; see also Ioannis Lianos, *La transformation du droit de la concurrence par le recours à l'analyse économique* (ANT.N.Sakkoulas, Athens, Bruylant Bruxelles, 2007).

or 'directly competitive or substitutable' is the market place,"[13] a view endorsed by the Appellate Body.[14]

C. Interaction between Trade and Competition Policy

While competition policy focuses primarily on the goals of efficiency and consumer welfare, trade policy seeks to protect the interests of a country's producers. This potentially antagonistic juxtaposition of competition and trade policy reflects a necessarily unstable relationship.

Over the last 50 years, the GATT/WTO has led to an effective reduction of governmental barriers to trade. Tariff and non-tariff barriers as well as regulatory obstacles have been either eliminated or reduced. By contrast, while the benefits of rules for business behaviour are generally recognized, none have as yet been developed at the international level. However, trade liberalization and globalization of business activities also resulted in concomitant globalization of anti-competitive practices. More and more WTO Members have, consequently, adopted national competition policies so as to protect the economic welfare benefits of governmental trade liberalization and deregulation against nullification through barriers set up by business having the same effect. Thus, national competition laws may effectively tackle anti-competitive practices which are exclusively implemented in a domestic market, but are carried out by firms operating from third countries. But national competition laws and law enforcement institutions, especially those of DCs, are not always fully equipped to deal with trans-boundary anti-competitive practices. This has prompted UNCTAD to adopt, on 5 December 1980, a comprehensive Code on Restrictive Business Practices (RBPs), the *United Nations Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices*, hitherto the sole fully multilateral instrument in this field.

Its primary objective is to ensure that RBPs do not impede or negate the realization of benefits that should arise from the liberalization of tariff and non-tariff barriers affecting world trade, particularly those affecting the trade of DCs. The "Set" is universally applicable to all enterprises, all countries, all regional groupings and all transactions in goods and services, but is voluntary in nature.

The Third UN Review Conference held in November 1995 affirmed the fundamental role of competition law and policy, and recommended to the General Assembly to convene a fourth such Conference under UNCTAD auspices in the year 2000. In the framework of the Fourth United Nations Conference to review all aspects of the set of multilaterally agreed equitable principles and rules for the control of restrictive business practices, which took place in Geneva from 25-29 September 2000, a *Model Law on Competition was drafted.*[15]

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[13] Panel Report, WT/DS8/R; WT/DS10/R; WT/DS11/R, 11 July 1996, at 6.22.

[14] *Japan – Taxes on Alcoholic Beverages*, Appellate Body Report, WT/DS8/AB/R; WT/DS10/AB/R; WT/DS11/AB/R, 4 October 1996, p. 16. See also European Communities – Measures Affecting Asbestos and Asbestos-Containing Products, Appellate Body Report WT/DS135/AB/R, 12 March 2001, at 103.

[15] An updated version of the UNCTAD Model Law on Competition was published in 2007, United Nations Conference on Trade and Development, Model Law on Competition, Sub-

It has been suggested in this respect that the WTO could in many ways take this initiative further, for instance examine how best to build upon the Set, e.g. by adding binding elements to agreed principles, and by considering new issues such as international cooperation.

Interdependence I: Convergence

There appears to be agreement on at least two points. The first is, that trade liberalization and competition policy share broadly similar goals, are interrelated and partially overlapping; and the second is that both affect access to markets, seeking greater efficiency in the production and allocation of goods and services through the removal of barriers to the competitive process. Indeed, the common goal of market access represents an important confluence between trade and competition policy. While the removal of external governmental trade barriers facilitates market entry, the control of anti-competitive conduct of market operators opens access to competitive markets. In combination, potential welfare gains derived from comparative advantage are made safe against anti-competitive erosion. This common goal also co-incides with the central function of the WTO which is to ensure equality of competitive opportunities for Members in the world trading system. As was noted in the GATT's *Oilseeds* Panel, "the CONTRACTING PARTIES have consistently interpreted the basic provisions of the General Agreement on restrictive trade measures as provisions establishing conditions of competition."[16] This view was firmly endorsed ten years later in the WTO Panel Report on *Argentina – Hides and Leather* which found that the Argentinian system of pre-payment of part of the applicable value-added tax and income tax was inconsistent with Art.III:2, first sentence of the GATT since the required pre-payments on imports exceeded the pre-payments to be made on internal sales of goods. It noted that this provision is not concerned with taxes or charges as such, or the policy purposes Members thereby pursue, but rather with the economic impact of these taxes or charges on the competitive opportunities of imported and like domestic products. The purpose of that provision, the Panel found, is to ensure "equality of competitive conditions between imported and like domestic products."[17]

These Panel findings illustrate the interdependence of trade and competition policy. Both are complementary in the sense of being mutually supportive, so that neither could fully achieve its objectives without the other. However, such interdependence is multifaceted and includes elements of both conflict and convergence. Furthermore, a perception of interdependence should not obscure the fact that the application of existing trade instruments could be inconsistent with the goals of competition policy. In fact closer analysis of that interdependence reveals three aspects: those which are complementary (for example the prohibition under competition law of predatory practices which deter market access after the elimination of the conventional trade barriers of tariffs and quo-

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stantive Possible Elements for a competition law, commentaries and alternative approaches in existing legislations, United Nations, 2007.

16 GATT Panel Report on *European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, adopted on 25 January 1990, BISD 37S/86.

17 Panel Report on *Argentina – Measure Affecting the Export of Bovine Hides and the Import of Finished Leather*, WT/DS155/R, adopted on 16 February 2001, paras. 11.174-11.284.

tas); those which are antagonistic (for example the application of antidumping measures triggered by prices that were not actually harmful to competition in the importing country); and those which were actually or potentially substitutable (for example provisions of competition law relating to price discrimination might in some instances serve as a substitute for antidumping measures).

Interdependence II: Divergence

GATT/WTO law also differs in several ways from competition laws.

Competition law typically covers at least potential restrictions relating to horizontal restraints, vertical restraints and abuses of a dominant position. Merger control review is also generally considered a very important component of competition law.

Some trade policies aim at protecting import-competing producers rather than competition and consumer welfare. Thus, provisions on safeguards, antidumping and countervailing duties are notoriously used for restricting import competition without due regard to objectives of open markets, undistorted competition and consumer welfare. GATT/WTO law is also intergovernmental law, notwithstanding persistent arguments by some academic commentators that many of their provisions appear to be directly applicable.

By contrast, national – and even international competition rules such as those in the EC – are interpreted as conferring directly applicable rights upon producers, traders and consumers and are enforceable through domestic courts. Furthermore, some regional arrangements protect free trade and undistorted competition through prohibitions of both governmental and private trade restrictions and competitive distortions.[18] They have also replaced their trade protection rules such as antidumping rules, by competition rules. GATT/WTO law, on the other hand, does not require mutually consistent trade and competition rules, and includes only a few rules on private restraints on competition.[19]

Notwithstanding these differences, the question must be asked whether it follows necessarily that the GATT/WTO approach is ineffective or obsolete.

D. The Spread of national competition laws and their diversity

Since 1989 antitrust law has been spreading rapidly among former communist countries and significant numbers of DCs.

Existing *competition laws* or codes can be classified on a scale from hard law to soft law. The US system reflects traditional hard law. It features clear prohibitions, intrusive investigative techniques (secret grand jury interrogation, wired informants, search and seizure, etc.), high fines, criminal penalties including jail sentences and private actions facilitated by broad pre-trial discovery, class actions, contingency fees and automatic treble damage and attorney fee awards to even nominally successful plaintiffs (but no fee

[18] Arts. 85-94 EC; the Australia-New Zealand Closer Economic Relations Agreement; Agreement Establishing the EEA.

[19] Arts.VI, XVII GATT; Arts.VIII, IX GATS; GATS Protocol on Basic Telecommunications; Art. 40 TRIPs.

awards to successful defendants). It is applied with aggressive extraterritoriality against foreign firms that conspire to reduce competition in US imports. On occasion, US law can also be used against foreign schemes that hinder US exports.[20]

The competition system of widest (internal) application is that of the European Community. It features very high fines for cartel or market allocation schemes, intrusive investigations (dawn raids) and substantial pressures for the reporting of mergers, joint ventures and large-scale restrictive distribution schemes. However, unlike the law of the United States, it does not apply to natural persons, does not provide for criminal law penalties, nor for treble damages or other features that would make private actions likely. In fact, almost none have been pursued successfully.

United Nations and OECD codes provide the clearest examples of soft law in regard to competition issues.

The idea of a coordinated or even harmonized competition policy within the legal framework of the WTO has repeatedly been addressed since the Uruguay Round as, due to spillovers, policy areas that have traditionally been seen as merely "internal", have increasingly become "trade" topics.[21] Views on the merits and possible modalities of introducing *competition law* disciplines into the WTO varied widely among analysts. Proponents took the view that antitrust rules belong in the WTO insofar as market access is affected. The case has also been made for inclusion on "constitutional" grounds – to bolster the WTO as a charter for international economic regulation. Opponents argue that the launch of negotiations on this topic will divert scarce policy-making resources in DCs away from issues that are more urgent in terms of domestic reform and market access pay-offs. Others opposed negotiations because of worries that an inappropriate "one size fits all" approach might emerge. Some competition authorities worried about the potential for "pollution" of *competition law* as a result of the introduction of market access considerations in enforcement; many saw little scope for international harmonization of antitrust rules and question whether the WTO would be the best forum for any such efforts, should they be pursued. The general thrust among antitrust authorities is to emphasize the need for co-operation among different jurisdictions to reduce uncertainty and transaction costs. Many in the trade community are keen to avoid the use of competition principles to constrain the application of trade policy.

On the other hand, Karl Meessen, a representative of another group of opponents, argues that the absence of harmonization of competition laws would entail a "competition of competition laws". The making of competition law would still take place under competitive conditions, as the different legal systems would compete in order to find the best legal solutions to maximize their economic performance. This competitive situation between the different national and supranational competition laws would finally result in an "open-ended process of dynamic competition".[22]

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[20] This approach can be understood as an expression of the concept of the "competitive state", incorporating the notion that it is not the states but the firms that compete, *cf.* Robert Gilpin, *Global Political Economy – Understanding the International Economic Order* (Princeton University Press, 2001), p. 183.

[21] John H. Barton, Judith L. Goldstein, Timothy E. Josling, Richard H. Steinberg, *The Evolution of the Trade Regime – Politics, Law, and Economics of the GATT and the WTO* (2006) at 20.

[22] *See* Karl M. Meessen, *ICN Accompanied Convergence, Instead of WTO Imposed Harmonization of Competition Laws,* in Harald Hohman (ed.), *Agreeing and Implementing the Doha Round* (2006) pp. 485-510, at 501 f.

E. Singapore et après

At the Singapore Ministerial Conference in 1997, it was decided to establish a "Working Group on the Interaction between Trade and Competition Policy". That Group was mandated "to study issues raised by WTO Members relating to the interaction between trade and competition policy, including anti-competitive practices, in order to identify any areas that may merit further consideration." The Ministerial Declaration also stipulated that the Group should have regard to the existing WTO provisions in this area including under the TRIMS Agreement and should ensure that the development dimension is taken fully into account.[23]

The WTO Ministerial Conference in Doha (2001) agreed that negotiations on this subject are to be launched at the fifth WTO Ministerial Conference in 2003, on the basis of explicit consensus on the modalities of such negotiations. They instructed the Working Group to focus, until the WTO Ministerial Conference in Cancún (2003), "on the clarification of core principles, including transparency, non-discrimination and procedural fairness, provisions on hardcore cartels, modalities for voluntary cooperation and support for progressive reinforcement of competition institutions in developing countries through capacity building".

At the Ministerial Conference in Cancún (2003), no consensus could be reached on modalities for negotiations in this area, although Ministers "reaffirmed all their Doha Declarations and Decisions and recommitted themselves to working to implement them fully and faithfully".

In the "July 2004 package" adopted 1 August 2004, the WTO General Council decided that the issue of competition policy "will not form part of the Work Programme set out in that Declaration and therefore no work towards negotiations on any of these issues will take place within the WTO during the Doha Round".

The Working Group is currently inactive but the WTO Secretariat continues to respond to national requests for technical assistance in this area for the benefit of interested WTO Members and countries seeking accession to the WTO.

F. Existing WTO Disciplines and Agreements

From a legal as well as a policy point of view, an important question is what the WTO does to allow members to deal with competition law-related "terms-of-trade" spillovers – meaning the effects the ratio of the price of export commodities to the price of import commodities has on areas in connection with competition law – and what could be done to allow existing disciplines to be used more effectively.

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[23] The establishment of the Group was welcomed, *inter alia*, by the EC and its Member States, both taking the view that there is a role for the WTO to encourage its Members, irrespective of their level of development, to enact and effectively apply a domestic competition law. Work in the WTO could contribute to the avoidance of conflicts of law and jurisdiction between Members and to the promotion of gradual convergence of competition laws.

I. The WTO and national antitrust law

The GATT does not impose common competition law disciplines on its CONTRACTING PARTIES. This contrasts with the ITO Charter, which contained specific provisions on the treatment of private restrictive business practices (RBPs). These matters are arranged differently under the GATS. Article VIII GATS imposes a legal obligation on WTO Members to ensure that national monopolies do not, through their behaviour, erode the value of general obligations and specific commitments (although the narrow definition of the term "monopoly supplier" in Article XXVIII(h) GATS severely limits the coverage of this obligation). Article IX GATS requires consultations with respect to RBPs not covered by Article VIII. The combined effect of the two provisions only marginally circumscribes competition law of WTO Members. With respect to telecoms, the Annex and the Reference Paper on telecoms go further and impose obligations to interconnect, limits (albeit loosely defined) on access pricing, and obligations relating to "bundling" etc. These disciplines are sector-specific only, not general, they are binding only on those WTO Members which have voluntarily made commitments in the telecoms sector. Therefore, it is not surprising that the first WTO antitrust case was decided in the telecom sector, in the case *Mexico – Measures Affecting Telecommunications Services*.

Thus, WTO Members are free to adopt any *competition law* they wish, the only constraint that is potentially imposed is non-discrimination (national treatment) (Article III GATT). National *competition law* is covered by national treatment insofar as its enforcement is a "requirement affecting" trade. GATT case-law makes it clear that WTO Members are required to provide products of foreign origin with opportunities equal to those available to domestic products as regards access to distribution channels (the 1980s Alcoholic Beverages cases). The 1997 *Kodak-Fuji* case made it clear that *competition laws* are covered by the national treatment obligation, explicitly by subjecting Japanese *competition law* to the national treatment obligation, and implicitly by accepting that the term "affecting" extends to national *competition laws*.[24]

The practical implication of this is that national *competition law* should treat products of foreign and domestic origin equally. The national treatment discipline is not concerned with the treatment of entities (physical or legal persons); the only concern is with the treatment of products resulting from government policies. Say a company incorporated under US law and another incorporated under EC law both abuse a dominant position in the EC, but that they produce different goods. If the EC competition authority intervenes only against the US firm, there is no violation of national treatment under the GATT. The GATT concern for the purposes of Article III.4 is whether a government measures treats "like" foreign products less favourably. Moreover, the WTO engages the responsibility of governments only and not of private parties. The terms "laws", "regulations", and "requirements" in Article III.4 denote some form of positive action by governments. Mere tolerance of RBPs is not enough, there must be some positive action (say, a "comfort" letter).

A recent prominent decision by the European Court of First Instance illustrates the considerable implications the application of national (or in this particular case rather "supranational") competition law can have not only for foreign companies but for the

[24] This was the case of the United States versus Japan in the matter concerning Eastman Kodak and Fuji Film: *See* the Panel Report on *Japan – Measures Affecting Consumer Photographic Film and Paper*, WT/DS44/R, adopted on 22 April 1998, paras. 10.376-7.

world market as a whole: The Microsoft-judgment has been subjected to serious criticism, *inter alia* raising the question: Is the EC bypassing the WTO by imposing tariffs under the guise of anti-trust merely on the basis of market share?

The *Microsoft* case originated with a December 1998 complaint from Sun Microsystems alleging that Microsoft was refusing to supply it with interoperability information necessary to interoperate with Microsoft's dominant PC operating system. In February 2000, following information obtained from the market, the Commission broadened the scope of its investigation to examine Microsoft's conduct with regard to its Windows Media Player product.

On 24 March 2004 the European Commission adopted a decision[25] finding that Microsoft had infringed Article 82 of the EC Treaty by abusing its dominant position by engaging in two separate types of conduct. The Commission also imposed a fine of more than EUR 497 million on Microsoft.

The first type of conduct found to constitute an abuse consisted in Microsoft's refusal to supply its competitors with "interoperability information" and to authorise them to use that information to develop and distribute products competing with its own products on the work group server operating system market, between October 1998 and the date of adoption of the decision. By way of remedy, the Commission required Microsoft to disclose the "specifications" of its client/server and server/server communication protocols to any undertaking wishing to develop and distribute work group server operating systems. The second type of conduct to which the Commission took exception was the tying of Windows Media Player with the Windows PC operating system. The Commission considered that that practice affected competition on the media player market. By way of remedy, the Commission required Microsoft to offer for sale a version of Windows without Windows Media Player.

In order to assist the Commission in monitoring Microsoft's compliance with the decision, the decision provided for a monitoring trustee to be appointed by the Commission from a list of persons drawn up by Microsoft. All the costs associated with the monitoring trustee, including his remuneration, were to be borne by Microsoft. On 7 June 2004 Microsoft brought an action before the Court of First Instance of the EC for annulment of the decision or for annulment or a substantial reduction of the fine imposed on it.

On 17 September 2007, the Court of First Instance essentially upheld the Commission's decision finding that Microsoft had abused its dominant position. The Court found that the Commission did not err in assessing the gravity and duration of the infringement and did not err in setting the amount of the fine. The Court only annulled certain parts of the decision relating to the appointment of a monitoring trustee, which have no legal basis in Community law. However, since the abuse of a dominant position is confirmed by the Court, the amount of the fine remains unchanged at EUR 497 million.[26]

In practical terms the ruling means that Microsoft will have to make all its software compatible with its rivals.

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[25] Commission Decision of 24 March 2004 relating to a proceeding under Article 82 of the EC Treaty (Case COMP/C-3/37.792 Microsoft), C(2004)900 final.

[26] Court of First Instance Case T-201/04, *Microsoft Corp.* v *Commission of the European Communities* Judgement of 17 September 2007; see also Court of First Instance of the European Communities, Press Release No 63/07, available online at http://curia.europa.eu/en/actu/communiques/cp07/aff/cp070063en.pdf.

II. Cartels and Article XI GATT

Under the "effects doctrine" (or objective territoriality), countries may take action against foreign practices that have negative effects in their markets. Cartels are an example. The WTO may be relevant in this connection through GATT Article XI, which states: "no prohibition or restriction … shall be instituted or maintained … on the exportation or sale for export". Export cartels are a restriction on exports. An interpretative note ad Article XI (which, according to Article XXXIV of the General Agreement, is an integral part of that Agreement) specifies that, with regard to the application of the exception to processed products that "… [i]n particular, it should not be construed as permitting the use of quantitative restrictions as a method of protecting the industrial processing of agricultural or fisheries products."[27]

As with national treatment, the threshold issue is whether the export cartel can be attributed to government behaviour. On this, a GATT panel held in *Japan Semiconductors* that a "but for" test should be used, i.e., to what extent the observed behaviour would have taken place absent government involvement.[28] Unfortunately, the precise degree of government involvement was not specified and thus it is doubtful whether mere "tolerance" of a cartel suffices. Arguably, however, even passive behaviour could be caught by Article XI, given that the term "restriction" invites a wider reading than the terms "law", "regulation" or "requirement" mentioned in Article III.4. A legislative (rule-making) initiative could usefully clarify this grey area. A GATT amendment, however, would be highly unlikely.

The second issue of importance is the form cartel action takes. If competition is limited by way of quotas and there is a government measure supporting the cartel, the practice can be challenged in the WTO. The same may be true if the instrument used is a price agreement. Indeed, the *Japan Semiconductors* Panel argued that increases in prices due to cartel-type behaviour is caught by Article XI, as it decreases the volume of sales. All this suggests that with marginal additional interpretation of GATT rules, cartels can already be addressed in the existing WTO framework if the national enforcement capacity exists.

III. Non-violation complaints (Article XXVII.1(b) GATT)

Non-violation complaints can provide a means to attack RBPs in the WTO. What is needed is that a plaintiff shows that (i) the value of concessions (ii) was reduced by a subsequent measure that (iii) is not illegal under the GATT but which (iv) could not have been reasonably anticipated when the concession was consolidated (bound). The *Kodak-Fuji* case was the first example in which this approach was used. The mention of the term "measure" again requires some form of positive action by the government. As contested measures are not illegal, the remedy cannot be the withdrawal of the practice concerned. Instead, the WTO adjudicating body will recommend that the Members con-

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[27] Havana Reports, ICITO/I/8, p. 94. See *Canada – Import Restrictions on Ice Cream and Yoghurt*, GATT Panel Report, L/6568, adopted 5 December 1989, BISD 36S/68, para. 60.

[28] Panel Report on *Japan-Trade in Semiconductors*, BISD, 35S/116, adopted on 4 May 1988; see also fn. 55 infra.

cerned "make a mutually satisfactory adjustment."[29] Thus, compensation can be sought to "rebalance" the terms of trade. Non-violation disputes can be valuable "transparency" devices to determine to what extent market access deals have been affected through the introduction of new domestic policies that could not have been foreseen at the time concessions were negotiated.[30]

IV. Competition Dimensions of existing WTO disciplines

Already the non-tariff barrier agreements of the Tokyo Round such as on subsidies, technical standards, and government procurement, though primarily for cross-border movement of goods, may in many cases also be relevant to the competitive conditions facing foreign investors.[31] Many WTO agreements have a competition dimension. For example, the Agreement on Safeguards prohibits the use of voluntary export restraints, orderly marketing arrangements and similar measures on either exports or imports, including compulsory import cartels, and states further that WTO Members are to refrain from encouraging or supporting the use of measures with equivalent effect by public or private enterprises.[32] Many, if not most trade policies, have anti-competitive effects. Indeed, apart from revenue objectives, presumably an objective of the government is to reduce competition from imports. However, trade policies may also be used by firms to support tacit or overt collusion as "facilitating practices."[33] Competition issues arise in the following WTO agreements.

1. Anti-dumping

Despite often being regarded as the example of a trade policy that is consistent with the objectives of *competition law*, most economists agree that the purported rationale of antidumping – to combat only predatory type pricing by foreign firms – is the exception, not the rule.[34] Instead, antidumping amounts to straightforward protectionism, with the added twist that it can be used strategically by firms to collude.

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29 Article XXVIII.1b Dispute Settlement Understanding.

30 Bernard Hoekman, Petros C. Mavroidis, *Competition, Competition Policy and the GATT,* World Economy 17 (1994), pp. 121-150.

31 Friedl Weiss, *Trade and Investment,* chapter 6 in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds.), *The Oxford Handbook of International Investment Law* (Oxford University Press, 2008) pp. 182-223, at 187.

32 Article XI:3 of the Agreement on Safeguards.

33 K. Krishna, *Trade Restrictions as Facilitating Practices,* Journal of International Economics 26 (1989), pp. 251-70.

34 Robert Z. Lawrence (ed.), *Brookings Trade Forum 1998* (Brookings Institution Press, 1989); Richard J. Pierce Jr., Antidumping Law as a Means of Facilitating Cartelization, Antitrust Law Journal 2000, issue 3, 67; Christopher T. Taylor, The Economic Effects of Withdrawn Antidumping Investigations: Is there Evidence of Collusive Settlements ?, Federal Trade Commission Bureau of Economics, Working Paper 240, 2001, Washington D.C.

In his book *Dumping: A Problem in International Trade*,[35] published in 1923, Jacob Viner analysed the nature and causes of dumping. This economic analysis remains still valid, but the debate has shifted since the early 1990s and now centers on the problems posed by antidumping, the system put in place to eliminate dumping.[36]

The protectionist nature of antidumping laws is illustrated by their history. The first antidumping law was enacted by Canada in 1904 with the objective of protection against steel dumped in Canada by U.S. firms. The United States first enacted an antidumping law in the Revenue Act of 1916 (1916 Act). Section 801 of the 1916 Act, commonly referred to as the "Antidumping Act of 1916", allows civil actions and criminal proceedings to be brought against importers who "commonly and systematically" have imported or sold foreign-produced goods in the United States at prices which are "substantially less" than the prices at which the same products are sold in a relevant foreign market, provided that such action is committed with the intent of "destroying or injuring an industry in the United States, or of preventing the establishment of an industry in the United States, or of restraining or monopolizing any part of trade and commerce in such articles in the United States". This act was born out of fear that after the end of World War I European – especially German – firms would try to regain their position on the American market through predatory selling practices, thus threatening the newly established pre-eminence of American industries.[37]

The 1916 Act was only rarely applied. There are no criminal cases reported under the 1916 Act. Before 1975 only one civil case was reported. Since 1975, the Act has known a little "revival" and a modest amount of jurisprudence emerged. None of the cases led to the imposition of sanctions but several of the cases brought regarding steel imports raised concerns that the Act would be used as a tool to intimidate foreign competitors.[38]

Finally, the so-called *Geneva Steel* case, which was directed against two importers of European steel, led to a complaint lodged by a European steel federation under the "Trade Barriers Regulation".[39] After investigation, the European Commission decided in June 1998 to request consultations with the US "regarding the failure of the United States to repeal the 1916 Act" pursuant to the WTO rules on dispute settlement. After the failure of these consultations, the EC requested on 1 February 1999 the establishment of a panel to review its claims that the 1916 Act violated Article XVI.4 of the Agreement Establishing the WTO, Articles VI.1 and VI.2 of the GATT 1994 and Articles 1, 2.1, 2.2, 3, 4 and 5 of the Anti-Dumping Agreement or in the alternative, that the 1916 Act was

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35 Jakob Viner, *Dumping: A Problem in International Trade* (University of Chicago Press), 1966 (1923).

36 Maurizio Zanardi, *Antidumping: A problem in international trade*, European Journal of Political Economy, vol. 22, no. 3, 2006, pp. 591-617.

37 In 1922, the Congress passed a second law, the 1921 Antidumping Act, which was, as an alternative to criminal laws, providing administrative remedies, see Alfred E. Eckes Jr., *U.S. Trade History*, in William A. Lovett, Alfred E. Eckes Jr., and Richard L. Brinkman, *U.S. Trade Policy – History, Theory, and the WTO* (2nd ed., M.E. Sharp, 2004), pp. 36-921, at 52.

38 *See* Philip De Keyser, *Exploring WTO dispute settlement in US Anti-dumping Act 1916: An easy case?*, Jean Monnet Working Paper (2001).

39 Council Regulation (EC) No 3286/94 of 22 December 1994 laying down Community procedures in the field of the common commercial policy in order to ensure the exercise of the Community's rights under international trade rules, in particular those established under the auspices of the World Trade Organization.

in breach of Article III.4 GATT. In February 1999, Japan also decided to have recourse to the WTO dispute settlement system. Japan's decision was triggered by the *Wheeling-Pittsburgh* case, which was directed against nine foreign companies, including three importers of Japanese steel. In both cases, the panels found that the 1916 Act substantially violated several provisions the WTO antidumping Provisions.

Introduction of competition criteria into the "rules of the game" for contingent, i.e. antidumping protection has repeatedly been proposed by academic commentators as a means of reducing its considerable impact on domestic competition.[40] This, it has been suggested, could be done by a conceptual shift from a concept of injury to competitors to one of injury to competition. One way this could be achieved is to use the same tests that competition authorities would use to determine whether price discrimination or selling below cost is anti-competitive. At a minimum, competition authorities should have the mandate to determine whether antidumping duties-and, indeed, trade policies in general-may lead (or have led) to an excessive reduction in competition on the domestic market. Finally, as pointed out by Messerlin,[41] antidumping could be made subject to appeal on the basis of competition concerns, since there have been a number of EU antidumping cases brought by firms that were also subject to antitrust investigations.

2. Intellectual Property

The TRIPs Agreement allows governments to take measures to control anti-competitive practices in contractual licences that adversely affect trade and may impede the transfer and dissemination of technology. One *competition law* issue that arises in the TRIPs context is the treatment of parallel imports. The agreement leaves this to the discretion of each member, but events in the 1990s illustrated that some countries would like to see disciplines in this area. Space constraints prohibit a detailed discussion of this issue. Recent research[42] reveals that the case for harmonization of rules is weak in itself. However, restrictions on parallel trade may be required if countries decide to accept differential pricing for patented medicines.

3. Services

As mentioned above, the GATS recognizes that business practices may restrain competition and thus trade in services, but no obligations are imposed on members regarding either the scope or the enforcement of *competition law*. However, the 1997 agreement on basic telecommunications introduces (voluntary) disciplines on issues such as interconnection in recognition of the fact that private dominant players in the telecoms market, left free to

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40 *Cf.* e.g. Patrick Messerlin, *Should Antidumping Rules be Replaced by National or International Competition Rules?,* Aussenwirtschaft 49 (1994), pp. 351-74; Bernard Hoekman, Petros C. Mavroidis, *Dumping, Antidumping and Antitrust,* Journal of World Trade 30 (1996), pp. 27-52.

41 Patrick Messerlin, *Antidumping Regulations or Pro-cartel Law? The EC Chemical Cases,* The World Economy 13 (1990), pp. 465-92.

42 *See* Keith Maskus, *Intellectual Property Rights in the Global Economy* (Institute for Intemational Economics, Washington, DC, 2000); Martin Richardson, *An Elementary Proposition Concerning Parallel Imports,* Journal of International Economics 56 (2002), pp. 233-45.

make decisions about how to treat other suppliers, may frustrate negotiated market access commitments. Services are activities where there is often need for some type of regulation to address market failures or achieve social (non-economic) objectives. Technological developments and ongoing processes of privatization of service industries have major implications for the design of appropriate regulatory instruments to ensure both efficiency and equity. Many of the "backbone" services that are critical to development-transport, energy, telecoms, and finance-are industries where network externalities are important. An implication is that regulation should focus on ensuring that markets are contestable. Doing this is anything but trivial[43] – implying a need to strengthen domestic institutions and a careful approach towards the setting of enforceable international standards in the WTO. An open issue on which more research is needed that focuses on the developing country context, is that of the applicability of *competition law* as a discipline when compared to sectoral regulation. Most jurisdictions have tended to follow a regulatory route, even for service markets that have been liberalized, in part reflecting social and equity considerations, as well as public good concerns (prudential regulation etc.).

In this context, one might recall Klaus Hopt's memorable phrase that "Wettbewerb ist eine staatliche Veranstaltung."[44] The same can be said of so-called "competition culture", whatever that might mean. It is a national culture, or at best a regional one.

What works best in different country contexts? What role/need is there for international cooperation? Cartels (de jure or de facto) of service-providing enterprises may have a greater negative impact on DCs. Examples are air and maritime transport cartels-generally supported by governments-and computer reservation systems, where the risk of dominant positions being abused is non-negligible. Determining the relative importance/magnitude of private (that is, governmentally tolerated) practices as compared to those created by government policies is another important area for further research.

4. Product Standards

The WTO Agreement on Sanitary and Phytosanitary Measures (SPS) and the Agreement on Technical Barriers to Trade (TBT) also comprise a competition dimension. Both require WTO Members to adopt the least trade restrictive measure when pursuing a regulatory objective. Under the SPS Agreement the complaining Member merely has to raise a *prima facie* case showing a breach of the Agreement for the burden of proof to fall on the defending Member to show that its measures are, in fact, consistent with the SPS Agreement. In this way, the SPS Agreement seeks to bar both deliberate protectionist SPS measures and those which, though corresponding to a genuine health concern, are unnecessary because they are either not based on scientific evidence or are more trade restrictive than they need to be.[45] This might prove a difficult test to apply. Regulatory ac-

[43] *See* recent discussions of finance and energy by Claessens and Evans: Claessens, C. (2002). *Regulatory reform and trade liberalization in financial services* (Amsterdam: University of Amsterdam, (mimeo)); Evans, P. (2002). *Energy services, domestic regulation and the WTO* (Center for International Studies + MIT (2002)).

[44] Klaus J. Hopt, *Wettbewerbsbeschränkungen und Verrechtlichung*, in F. Kübler (ed.), *Verrechtlichung von Wirtschaft, Arbeit und sozialer Solidarität* (Suhrkamp, 1985) p. 229, 287.

[45] Catherine Button, *The Power to Protect. Trade, Health and Uncertainty in the WTO* (Hart Publishing, 2004) p. 80.

tion is thus significantly constrained and all major SPS cases have been lost by defending Members.[46] Given that standards can be used to exclude competitors from the market, it would appear important to strengthen mechanisms to allow enterprises to contest proposed standards. This is something that goes beyond the WTO, as standards are not set in the WTO, and will require significant capacity-building efforts. It may also imply a need to reconsider the emphasis given to harmonization of technical regulations to international norms. Harmonization may not be optimal, in part because the standards-setting process can be captured and used in protectionist ways to "raise rivals' costs".[47]

5. Procurement

Another set of WTO disciplines where competition issues arise is government procurement.[48] It is well known that collusive tendering occurs in many settings and that this can be expected to occur more frequently in settings where competitive and transparent bidding procedures are not followed. This is an area where the introduction of effective competition is vital to reduce costs. However, even if such mechanisms are applied, tenders for products that are non-tradable can easily give rise to attempts to collude-construction contracts are an example that is often noted in the literature. To address such collusive practices a domestic antitrust mechanism may be useful. But it is more important to design procurement systems that generate competition between potential suppliers, create incentives for whistleblowers and allow for challenges to be brought during the process of procurement.

Being an important sector of the European economy (16,3 % of the EC GDP), public procurement is also subject to European Community rules. In the framework of the EC internal market, a number of directives giving detailed instructions on tendering procedures are governing the subject of public procurement.[49] The directives set out the principles for works, supplies, services and utilities contracts which are above specified financial threshold levels. Under these rules public sector procurement must follow transparent open procedures ensuring fair conditions of competition for suppliers. Their aim is to prevent the risk of preferred treatment being given to national tenders or applicants when a contract is awarded by a contracting authority as well as to avert the risk that agencies financed or controlled by a state, a local authority, or other bodies controlled by public law allow themselves to be guided by other than economic interests.[50] In 2004, a legislative package of public procurement directives was adopted by the Council of the

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46 See the *Hormones*, *Salmon*, *Agricultural Products and Apples* Cases.

47 Hoekman, *Mavroidis*, Journal of World Trade 37 (2003), at 16.

48 See generally Marc Bungenberg, *Vergaberecht im Wettbewerb der Systeme*, Jus Publicum 163 (Mohr Siebeck, 2007).

49 On the first generation of EC Procurement Directives and the evolution of the procurement regime see, Friedl Weiss, *Public Procurement in European Community Law* (The Athlone Press, London, 1993).

50 *Cf.* ECJ Case C-18/01, *Korhonen*, [2003] ECR I-5321, para. 52; ECJ Case C-237/99, *Commission/France*, [2001] ECR I-939. For further information on EC Public Procurement legislation see Gunther Gruber, Thomas Gruber, Annemarie Mille, Michael Sachs, *Public Procurement in the European Union – Directives and Case Law as at 01/03/2006* (NJW Neuer Wissenschaftlicher Verlag, 2006).

EU and the European Parliament.[51] These directives shall contribute to a simplification and modernisation of procurement procedures, for example by facilitating electronic procurement in the public sector.[52]

At the global level, meaning within the framework of the WTO, an Agreement on Government Procurement was first negotiated during the Tokyo Round and entered into force on 1 January 1981. Its purpose was to open up procurement markets as much as possible to international competition. The present agreement and commitments were negotiated in the Uruguay Round. These negotiations achieved a 10-fold expansion of coverage, extending international competition to include national and local government entities whose collective purchases are worth several hundred billion dollars each year. The new agreement also extends coverage to services (including construction services), procurement at the sub-central level (for example, states, provinces, departments and prefectures), and procurement by public utilities. The new agreement took effect on 1 January 1996.

The WTO Agreement on Government Procurement also reinforces rules guaranteeing fair and non-discriminatory conditions of international competition. For example, governments will be required to put in place domestic procedures by which aggrieved private bidders can challenge procurement decisions and obtain redress in the event such decisions were made inconsistently with the rules of the agreement.

6. Agriculture

Agricultural export and production subsidies have well-known effects on competition and are a priority negotiating issue for many DCs. Marketing boards, state-trading, the exercise of monopsony power by multinational buyers, restrictive conditions imposed on access to-and the use of-seeds, and food safety and related labelling standards set by retailers are examples of practices and policies that can have major implications for competition on markets for agricultural products.

In sum, many competition issues arise in existing WTO agreements. Some of the issues just discussed require mechanisms to induce competition among suppliers, but not necessarily national antitrust enforcement (e.g., procurement). Others require international co-operation and action outside of the WTO (e.g., development of international product standards). Traditional GATT-type market access commitments are needed in several areas (e.g., services), complemented by a willingness to address entry restrictions

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[51] Christopher Bovis, *EC Public Procurement:Case Law and Regulation* (OUP, 2006).

[52] This legislative package is made up of Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors, and of Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, implemented by Commission Regulation (EC) No 1564/2005 of 7 September 2005 establishing standard forms for the publication of notices in the framework of public procurement procedures pursuant to Directives 2004/17/EC and 2004/18/EC of the European Parliament and of the Council, and by Commission Directive 2005/51/EC of 7 September 2005 amending Annex XX to Directive 2004/17/EC and Annex VIII to Directive 2004/18/EC of the European Parliament and the Council on public procurement.

and market distortions that are supported by or are the result of government policies (e.g., agricultural subsidies). To some extent existing rules could also usefully be clarified to facilitate the use of the WTO as an instrument to ban discriminatory conditions of competition for foreign products. Whether pro-competitive liberalization and de- or re-regulation deserves priority over the adoption of multilateral disciplines on national antitrust is something that must be answered on a case-by-case basis. It is to be expected that in many of the instances identified, such disciplines will have a lower pay-off than alternative options for most low-income countries.

V. Provisions mandating further review or negotiation

Several WTO Agreements provide for review of their operation with a view to adding some competition rules. Thus, the Agreement on Trade-Related Investment Measures (TRIMs) mandates the Council for Trade in Goods, not later than five years after its entry into force, to "consider whether it should be complemented with provisions on investment policy and competition policy".[53] At its meeting of 15 October 1999, the Council for Trade in Goods launched the review of the operation of the TRIMs Agreement.

This provision which was requested by DCs should make it possible to confront anti-competitive practices by multinational enterprises. Review is also envisaged by the Agreement on Pre-shipment Inspection possibly leading to future negotiations on additional competition rules.[54]

The GATS, as has been shown, recognizes "that certain business practices of service suppliers may restrain competition and thereby restrict trade in services".[55] This provision may well give rise to future negotiations on "specific commitments" regarding the liberalization of such private RBPs, an issue which is also likely to make or break future negotiations on Sectoral Agreements e.g. on Air and Maritime Transport Services.

All the above mentioned existing provisions may indeed appear feeble, haphazard or simply inadequate. Yet one is bound to admit that they also comprise dynamic elements that may be activated if need be. Naturally, their intrinsic ambiguities and weaknesses will continue to fuel demands for world competition rules, but it would be hard to argue that the WTO is alarmingly bereft of any modicum of competition rules. It would seem premature, therefore, to rush into currently unrealistic multilateral negotiations.

VI. Panel practice

As was mentioned before, the GATT/WTO approach is focused on the progressive *liberalization of governmental barriers* to market access and by means of its inter-governmental system of dispute settlement. This is also confirmed by GATT panel practice.

Just as GATT and WTO law has always focused on governmental market access barriers and market access distortions, GATT and WTO dispute settlement procedures have been used almost exclusively for reviewing governmental trade restrictions and distortions.

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53 Art. 9 of the TRIMS-Agreement.

54 *Ibid.*, Art. 6.

55 Art.IX GATS.

In only less than 2 % of the more than 400 GATT (and WTO) dispute settlement proceedings have private anti-competitive business practices – with the alleged support of the government concerned – been challenged. For example, the 1988 Panel Report on *Japan – Trade in Semiconductors* which was dealing with Japan's export restrictions and "voluntary imports expansion commitments" pursuant to the Japan-US Semiconductor Agreement described the close relationship between the private cartel of Japanese producers and exporters of semiconductors and the supplementary governmental export restrictions. Yet, the Panel only found the governmental export restrictions to be inconsistent with Article XI.1 GATT.[56] Also the Panel Report on *Japan – Measures Affecting Consumer Photographic Films and Paper*[57] illustrated the close relationships between governmental and private market distortions, yet again was focused on the governmental measures. This view was confirmed by the Panel Report on *Argentina – Hides and Leather*, which referred to the Panel Report on *Japan – Film* with the following words: "It is well-established in GATT/WTO jurisprudence that only governmental measures fall within the ambit of Article XI.1."[58]

Mexican Telecom

In April 2004, however, the WTO Dispute Settlement Body (DSB) resolved the WTO's first antitrust case by adopting the Panel Report on *Mexico – Measures Affecting Telecommunications Services* ("the *Mexican telecom* case").[59] The Panel resolved the matter in favour of the United States' claim that Mexico had anticompetitively facilitated exploitative prices and a cartel that raised the price of terminating cross-border telephone calls in Mexico and thereby harmed trade and competition.

Mexico's specific commitments for telecommunications services under GATS Article XVIII (Additional Commitments) consist of undertakings pursuant to the so-called "Reference Paper," which contains a set of pro-competitive regulatory principles applicable to the telecommunications sector. The Panel found that Mexico had failed to maintain appropriate measures to prevent "anti-competitive practices" in violation of Section 1 of the Reference Paper. The Panel observed that the measures had effects tantamount to those of a market sharing arrangement between suppliers and in fact required practices by Mexico's major supplier that limited rivalry and competition among competing suppliers.

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56 Panel Report on *Japan-Trade in Semiconductors*, BISD, 35S/116, adopted on 4 May 1988.

57 Panel Report on *Japan – Measures Affecting Consumer Photographic Films and Paper*, WT/DS44/R, adopted on 22 April 1998.

58 Panel Report on *Argentina – Measure Affecting the Export of Bovine Hides and the Import of Finished Leather*, WT/DS155/R, adopted on 16 February 2001, para. 11.18. However, in the Panel's view it did not follow from that statement or from the text of Article XI:1 that Members would be "under an obligation to exclude any possibility that governmental measures may enable private parties, directly or indirectly, to restrict trade, where those measures themselves are not trade-restrictive"; see also Panel Report on *EC – Countervailing Measures on Dynamic Random Access (DRAM) Chips from Korea*, WT/DS299, adopted on 3 August 2005.

59 Panel Report on *Mexico – Measures Affecting Telecommunications Services*, WT/DS 204/R, *see supra*.

The *Kodak-Fuji Film* case, it will be recalled, constituted the first significant yet ultimately unsuccessful attempt to bridge the trade–competition gap. The lesson to be drawn from that case was that the GATT rules are not sufficient to handle trade-and-competition (mixed public/private) restraints.

The *Mexican telecom* case arose from Mexico's GATS undertakings regarding the conditions of termination of telephone calls for foreign telecom operators in Mexico, and Mexico's undermining of its GATS commitments by "privatizing protection" – in words coined by Kodak when it pressed its case, unsuccessfully, against Japan and Fuji Film for exclusionary restraints that blocked its path to the Japanese market. In contrast to the *Kodak-Fuji Film* case, however, the Mexican case arose in the context of a WTO sectoral agreement that embodies antitrust commitments. Also unlike *Kodak-Fuji Film*, the defending country argued not that "We didn't do it" but that "We did it [We supported cartel pricing of a service to the foreign carriers] because we needed protection from competition in order to develop our market, and we have the sovereign right to regulate our market in the public interest even if the regulation restrains trade".[60]

VII. Possible elements of a WTO competition agreement

The notion of a WTO competition agreement is regarded (correctly) as different in kind from competition codes negotiated at the Organization for Economic Co-operation and Development (OECD) and UNCTAD in the 1970s and 1980s.[61]

The substantial impact of authorized WTO retaliation, combined with the post-Uruguay Round judicialization of WTO dispute settlement panel decisions, is creating the first seriously enforceable body of hard law governing international economic subjects.

WTO disputes have been transformed into highly judicialized international lawsuits, which are strongly fact-specific and usually enforceable, due to the availability of trade sanctions and the need to honour and comply with adverse rulings as a quid pro quo for the possibility of enforcing favourable rulings.

1. A Process-oriented approach

Building on the OECD model, the European Union has suggested that the basic initial elements of a WTO competition agreement would be notification, consultation, co-operation and positive comity. A notification requirement would obligate states to inform other states of competition cases affecting their nationals or their interests. Consultation would involve a discussion period before a controversial case is begun. Co-operation involves exchange of non-confidential information, and/or prosecutorial views, regarding anti-competitive conduct potentially affecting the requesting state. Positive comity is the obligation that a state commences an investigation, upon request, into conduct within its territory that is cognizable under its laws and also adversely affects the competitive opportunities of enterprises of the requesting state. These would usually be denial of market access cases.

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60 Eleanor M. Fox, *The WTO's First Antitrust Case – Mexican Telecom: A Sleeping Victory for Trade and Competition*, Journal of International Economic Law 9 (2006), pp. 271-292, 272.

61 *Cf.* UNCTAD Model Law on Competition, *op.cit.*

2. Minimum substantive elements

The most basic, but in a way the most controversial, aspect of an agreement would be a set of minimum elements of an acceptable competition law. Clearly, these elements would have to include provisions controlling cartel agreements such as price-fixing, bid-rigging, market allocation, and boycotts. The main issue in that regard would be whether a prohibition approach would be mandatory or not, as was the case in the United Kingdom until 1999. Another provision would regulate abuses of a dominant market position. However, there could be some controversy concerning whether creation of a dominant position must be an offence. This would probably be accepted, since it is the basic premise of most merger control systems.

Given the present trade emphasis on market access, it would seem certain that a provision against unduly restrictive vertical agreements would be treated as a necessary element of a basic competition law. Defining the standard of legality might be controversial, however. In the 1980 UN RBP Code, vertical restrictions were covered under provisions on abuses of a dominant position. Thus, the vertical restrictions of non-dominant firms were not covered at all. This approach would approximate present US enforcement policy, and would please many economists who doubt that vertical restraints by non-dominant firms can do much harm to consumers. But those focusing on practices such as Japanese *keiretsu* or other market access issues might prefer a broader coverage of exclusive or quasi-exclusive distribution arrangements.

It would seem likely that the United States and some other countries would prefer that a minimum law provide for private actions. Nevertheless, private actions have not flourished anywhere outside of the United States. There are possible variations, such as a private right to come before an administrative tribunal, or a private action which would be permissible only if based on a successful government case.

Ultimately, an agreement might deal with the thorny subject of exemption from the *competition law*. This subject has been studied at OECD level, but major differences have not yet been eliminated. Labour and agriculture are almost always exempt. Charities sometimes are. Exemptions for export associations, specialization agreements or "crisis cartels" are controversial. Coverage of professions is irregular, as is coverage of sports leagues.

In 1994, a group of academics put forth a draft WTO competition agreement based on the premise that a new WTO committee should be empowered to investigate and control the behaviour of specific enterprises. Thus, there appears to exist some support for the idea of an international competition agreement that, in one way or another, can be used to detect, control or even punish anti-competitive behaviour of specific enterprises.

A more likely purpose of a WTO competition agreement is to ensure the fairness and open nature of national *competition laws*. The RBP Code provides, *inter alia*, that states should operate a transparent, non-discriminatory *competition law*, and should co-operate in enforcement matters. The United States has suggested that foreign access to national antitrust laws should be a topic studied by the WTO competition committee.

3. Mandatory adoption of a competiton law?

One argument against the creation of a WTO competition agreement is that most, if not all, of its purposes have been achieved in other ways, due to other pressures.

One of the purposes of the TRIPs Agreement was to create a floor such that over time most Members would adopt an adequate law for the protection of intellectual property rights. Such goal has largely been achieved in regard to the adoption of antitrust legislation. Adoption of an effective competition law is a prerequisite for membership in the European Union and the European Free Trade Association (EFTA) and hence also features in the European Economic Area (EEA) based on the 1992 Oporto Agreement.[62] Thus, competition laws are largely standardized at a fairly high level in over 30 European countries. In 1995, one non-EU country, Switzerland, unilaterally adopted a similar law anyway. Furthermore, the OECD committee on competition law sets common goals and standards, and has expanded its reach to include countries such as Mexico and South Korea.

The NAFTA requires adoption of an antitrust law. Such laws are now also in effect in Brazil and Argentina. Virtually all the states of the former Soviet Union's sphere of influence have adopted anti-monopoly laws as a necessary method of the process of "de-Stalinization". Furthermore, both the World Bank and the IMF have championed antitrust laws as part of free market reforms for DCs desirous to obtain international development assistance. In response to such pressures, long-time holdout states such as Thailand and Indonesia adopted antitrust laws in 1999 and 2000 respectively.

In 2001, it was estimated that more than 90 of the 180 or so countries in the world now have a competition law in place.[63] The situation in the People's Republic of China (PRC) has changed lately. The PRC had laws against bid-rigging and a few other practices but no comprehensive antitrust regime. It was only on 30 August 2007 that the PRC's National People's Congress passed the Anti-Monopoly Law of the PRC which, under the rubric of "monopoly conduct" targets monopoly agreements among undertakings, abuse of dominant market positions by undertakings, and concentrations of undertakings. If one includes the PRC in the list of states within competition laws, it would appear that such laws are now extant in countries accounting for over 95 percent of world trade. However, there are also a few notable laggards, such as Egypt, Nigeria, and Malaysia, but even the first two of these are drafting legislation. With regard to some of the other states without a law, it is doubtful that they possess enough lawyers and economists to staff an agency or enough of a judicial system to enforce such complex legislation fairly and effectively.[64]

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62 See Friedl Weiss, *The Oporto Agreement on the European Economic Area – A Legal Still Life*, 12Yearbook of European Law (1992), pp. 385-431; Sven Norberg et al, *EEA Law, A Commentary on the EEA Agreement* (Fritzes, 1993).

63 *Cf*. Report of the Working Group on Interaction between Competition Policy and Trade to the Council, WT/WGTCP/5 (8 October 2001), para. 100.

64 Joel Davidow; Hal Shapiro, *The Feasibility and Worth of a World Trade Organization Competition Agreement*, Journal of World Trade 37 (2003), pp. 49-68, 61 f.

4. Rules on Enforcement

If the purpose of a WTO agreement were to encourage enforcement co-operation, this goal is also already largely achieved due to other factors. The major players in antitrust, the United States, the European Union, Japan, Canada, Germany, Australia and even Mexico have concluded criss-crossing bilateral enforcement co-operation agreements between them. Enforcement co-operation is an OECD principle and a voluntary principle of the UN principles of 1980. Enforcement co-operation often relates to obtaining information about foreign multinational corporations, or obtaining some form of sanctions against them. Countries that have no home grown multinationals are unlikely to be important players in enforcement co-operation. Thus, a WTO code containing a co-operation principle would probably not add very much, at least in the short to medium term.

The most significant, but controversial, effect of a WTO competition agreement would be the creation of rules or standards that could be enforced through dispute settlement. WTO dispute-settlement procedures apply to all signatories of "covered agreements", subjecting Members to being "sued" by other Members who claim to have suffered trade losses due to violation of a rule in such an agreement. For example, if a WTO competition agreement contained a duty (usually called "positive comity") to investigate and, if possible, remedy, trade restraints in one Member limiting market access by the sellers or investors of another, the requesting Member could invoke dispute and settlement proceedings due to the other Members's non-action. Possibly, if the competition code included a non-discrimination obligation, a Member could sue another whose antitrust law, for instance, provides lesser rights or less favourable treatment for non-nationals than for nationals.[65]

On the other hand, the WTO would be the ideal institutional vehicle into which an international competition agreement could be incorporated. As pointed out by Taylor, the WTO is by far the most effective of the existing potential institutional vehicles.[66]

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[65] An alternative would be to envisage the non-application of the Duspute Settlement Understanding of the WTO in favour of a looser multilateral control mechanism. This option would, however, run counter to the consensus principle of the WTO and the universal applicability of all its rules to all Members, see Giorgio Sacerdoti, Key Note Speech on Global Implications of Competition Law, Competition Issue in the Global Economy and the WTO, in C. Baudenbacher (ed.), Current Developments in European and International Competition Law, 15th St. Gallen International Competition Law Forum, vol. 10 ICF *(Helbing Lichthahn, 2009)*, pp. 303-317.

[66] The potential alternative institutional vehicles analysed by Taylor would be the OECD, the UN or a stand-alone treaty. *Cf* Martin Taylor, *International Competition Law – A New Dimension for the WTO?* (CUP, 2006) at pp. 286 ff.

VIII. Concluding Arguments against an international competition agreement

However, there are also a considerable number of arguments indicating that it would be premature as yet to embark on major negotiations for multilateral standard setting on world competition rules. This conclusion is based on the following considerations.[67]

First, the WTO approach, although an expanded continuation of the GATT approach, is still fresh, largely untried and capable of development.

Secondly, the *Kodak-Fuji Film* case does not constitute a vindication of those who impatiently push for global competition rules. On the contrary, in the light of settled GATT panel practice it was, perhaps, a "bad case" which would probably not normally have been brought, but for enterprising attorneys.

Thirdly, unlike in the case of the TRIPs Agreement which is crafted around provisions incorporated from pre-existing IPR agreements, a multilateral competition agreement would have no such pre-existing standards to fall back on.

Fourth, WTO Members and countries engaged in or contemplating entering accession proceedings who do not currently have competition laws on their books should first be encouraged to adopt effective legislation and, even more importantly, to enforce it.

Fifth, the *Mexico Telecom* case has not brought a world competition regime any closer. It is even becoming more remote as the networking model of ICN proves increasingly successful, within the natural limits of a non-coercive enterprise. Since 2001, however, as networking has taken a grip on transnational issues across many fields of law, the dominant international antitrust conversation has shifted from concepts of cosmopolitan world principles to practical details (e.g. timing of merger filings), cross-fertilization and slow evolution of common norms. The antitrust agencies of the world formed the International Competition Network (ICN), which – along with the continued work of the Organization for Economic Co-operation and Development – has taken centre stage as the forum for norm formation and for convergence of laws.

Sixth, proliferating Regional Trade Agreements (RTAs) constitute a new phenomenon with possible implications for global competition rules. During the last few years, RTAs have not only sharply increased in numbers, but have also evolved significantly in their regulatory provisions, scope and coverage.[68] The scope of most of the RTAs extends beyond tariff concessions in trade in goods, and also encompasses preferential commitments in services and innovative provisions in areas such as investment and/or increasingly also competition policy.[69] Such innovative provisions in these new areas may well furnish useful "modelling" material laying the ground for future multilateral rules on these issues. On the other hand, the different regulatory regimes established by

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[67] These considerations are partly drawn from a previous article of the author, see Friedl Weiss, *From World Trade Law to World Competition Law*, 23 Fordham International Law Journal (2000), pp. 251-273, at 273.

[68] Friedl Weiss, *Coalitions of the Willing: The Case for Multi-lateralism vs Regional and Bilateral Arrangements in World Trade*, in Calliess/Nolte/Stoll (Hrsg.), *Coalitions of the Willing: Avantgarde or Threat?*, Band 8, Göttinger Studien zum Völker-und Europarecht (Carl Heymanns Verlag , 2007) pp. 51-71.

[69] For a recent overview of the establishment of disciplines on Formation of Economic Partnerships see the 2007 Report by the Industrial Structure Council of METI, Japan on Compliance by Major Trading Partners with Trade Agreements-WTO, FTA/EPA and BIT available online at www.meti.go.jp/english/report/index.html.

RTAs also make international trade relations more complex and may undermine the core principles of the WTO, namely transparency,[70] predictability and non-discrimination.[71] Moreover, provisions on competition policy in RTAs are also used as a tool to put pressure on trading partners (meaning developing countries) by calling for harmonization of national competition laws.

For example, competition law can be found in the Japan-Singapore Economic Partnership Agreement (EPA) which came into effect in 2002. It provides that one of the objectives of the agreement is "encouraging effective control of and promoting cooperation in the field of anti-competitive activities".[72] The substantive part of the EPA contains a chapter on competition (chapter 12), which provides, *inter alia*, that "each Party shall, in accordance with its applicable laws and regulations, take measures which it considers appropriate and against anti-competitive activities, in order to facilitate trade and investment flows between the Parties and the efficient functioning of its markets."[73]

A number of the free trade agreements concluded by the EC with various partners (in particular those concluded with Latin American countries and the countries involved in Euro-Mediterranean cooperation) contain basic provisions on cooperation in competition matters.

Moreover, the EC has also concluded dedicated cooperation agreements on competition policy with the United States, Canada and Japan. Under these agreements, competition authorities on both sides exchange information and co-ordinate their enforcement activities. Each side may ask the other to take enforcement action (positive comity); and each side must take account of the other's significant interests when enforcing competition rules.[74]

Lastly, it is standard rule making practice in international law to require a critical mass of state practice from which to extract common principles, standards or rules for codification.

Indeed, international multilateral standard setting or treaty making needs to be firmly based on relevant state practice or risk failure, ineffectiveness, or just softness.

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70 Friedl Weiss, *Transparency as an element of good governance in the practice of the EU and the WTO: Overview and Comparison*, 30 Fordham International Law Journal (May 2007), Nr. 5, pp. 1545-1586.

71 World Trade Organization, *Annual Report 2007*, p. 60.

72 Industrial Structure Council METI, JAPAN, *2007 Report on Complicance by Major Trading Partners with Trade Agreements – WTO, FTA/EPA and BIT*, p. 663.

73 Art. 103(1) Japan-Singapore EPA.

74 European Commission – Competition, *Bilateral relations of competition issues*, http://ec.europa.eu/comm/competition/international/bilateral/index.html.

Leniency in the ECN Framework of Parallel Competences

Romina Polley[*]

A. No one-stop shop but parallel competences of NCAs and the European Commission in cartel cases

Currently there is no one-stop shop in Brussels for leniency applications in the EU.[1] In contrast, there is a system of parallel competences of NCAs and the European Commission in cartel cases under the applicable procedural rules in EC Regulation 1/2003.[2] Cartels capable of having an effect on trade between Member States, notably cases involving more than one Member State can therefore be dealt with by a single NCA, possibly with the assistance of NCAs of other Member States, several NCAs acting in parallel, or the European Commission. NCAs are only relieved of their competence, if the Commission decides to take the case and initiates proceedings,[3] while there is no hierarchy among different NCAs' investigations.

There is also no automatic case allocation mechanism in place. The European Commission and the NCAs coordinate case allocation on a case-by-case basis within the European Competition Network ("ECN") and try to identify which authority would be well placed to deal with a case according to the principles stipulated in the ECN Cooperation Notice.[4] Pursuant to the ECN Cooperation Notice, the Commission is particularly well placed to deal with a case if a conduct affects the territory of at least three Member States.[5] However, the European Commission is not obliged to handle such cases and does not necessarily always do so.[6] There have been cartel cases in which the

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1 For a discussion of lately proposed one-stop shop models, see C. Gauer and M. Jaspers, *Designing a European solution for a "one-stop leniency" shop* (2006) ECLR 685, 687.

2 Council Regulation (EC) No 1/2003 on the implementation of the rules on competition laid down in Article 81 and 82 of the Treaty (EC Regulation 1/2003) (2003) OJ L1/1 Art 3-5, 11.

3 EC Regulation 1/2003 Art 11(6). The question remains whether NCAs are in that case also barred from applying their national laws, see D. Schroeder, *Kronzeugenregelungen im Kartellrecht*, in I. Brinker, D. Scheuing and K. Stockmann (eds.), *Recht und Wettbewerb Festschrift für Rainer Bechtold zum 65. Geburtstag* (C.H. Beck, Munich, 2006) 437, 448; D. Schroeder and S. Heinz. *Requests for Leniency in the EU: experience and legal puzzles*, in K. Cseres, M. Schinkel and F. Vogelaar (eds.), *Criminalization of Competition Law Enforcement* (Edward Elgar, Cheltenham, 2006) 161, 168.

4 Commission Notice on cooperation within the Network of Competition Authorities (the Commission ECN Cooperation Notice) (2004) OJ C101/43, 8.

5 Commission ECN Cooperation Notice [14].

6 C. Gauer and M. Jaspers, *Designing a European solution for a "one-stop leniency" shop* (2006)ECLR 685, 685.

Commission did not take jurisdiction despite the fact that several Member States were affected, *e.g.*, for workload reasons.[7]

There is also a recent example of parallel investigative measures of an NCA, in that case the German Federal Cartel Office, and the European Commission. It appears that the Federal Cartel Office conducted an inspection at several confectionary companies on February 7, 2008 while the European Commission had already sent an information request in mid January to some of the companies that were dawnraided by the Federal Cartel Office.[8] Such parallel investigations are unusual.[9] Normally, NCAs take no further action as soon as the Commission takes ownership of a case, even though they are formally free to take action until the Commission opens proceedings,[10] which happens only late in the process, normally when the statement of objections is served on the parties.[11]

Case allocation may also change at a later stage of the proceedings, because of a change of the relevant facts, *e.g.*, a conduct which originally appeared to be limited to two Member States is more widespread across several Member States. The Commission may later take jurisdiction even if several NCAs already started an investigation.[12]

In case of a no action letter issued by the European Commission in which it states that it does not intend to take action based on a European leniency application, it is still possible that NCAs will start their own proceedings at the national level.

There is no way for applicants to influence the case allocation. While in most cases the competition authority where an application is filed remains in charge,[13] from a legal perspective filing a leniency application with one authority does not prevent another one from investigating the same cartel. The Commission states in the ECN Cooperation Notice that "the allocation of cases between members of the network constitutes a mere division of labor where some authorities abstain from acting. The allocation of cases therefore does not create individual rights for the companies involved in or affected by an infringement to have the case dealt with by a particular authority."[14] In light of the importance of case allocation in the absence of full harmonization of leniency programmes and procedural regimes in different jurisdictions and the risk of different ranks of leniency

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7 According to M. Siragusa and C. Rizza (eds.), *EU Competition Law: Volume III: Cartel Law,* (CLAEYS & CASTELLS, Leuven 2007) 3.134, through the end of 2005, six cases had been transferred from the Commission to a NCA.

8 See MLex Comment: German confectionary raids reveal novel co-operation with the EC of March 20, 2008 available under www.mlex.com

9 M. Siragusa and C. Rizza (eds.), *EU Competition Law: Volume III: Cartel Law,* (CLAEYS & CASTELLS, Leuven 2007) 3.145.

10 If an NCA has already acted on a case, the Commission shall initiate proceedings only after consulting with the NCA (EC Regulation 1/2003 Art 11 (6)).

11 M. Siragusa and C. Rizza (eds.), *EU Competition Law: Volume III: Cartel Law,* (CLAEYS & CASTELLS, Leuven 2007) 2.61; C Canenbley/M Rosenthal, *Co-operation Between Antitrust Authorities In-and Outside the EU: What does it Mean for Multinational Corporations?-Part 1* (2005) ECLR 106, fn. 22.

12 However, the so-called "atomic option" has not been used yet (M. Siragusa and C. Rizza (eds.), *EU Competition Law: Volume III: Cartel Law,* (CLAEYS & CASTELLS, Leuven 2007) 3.135).

13 Commission ECN Cooperation Notice (6); C. Gauer/M. Jaspers, *The European Competition Network, Achievements and challenges – a case in point: leniency* (2006) EC Competition Policy Newsletter 8, 8.

14 Commission ECN Cooperation Notice 31.

applications in different jurisdictions, this is unsatisfactory.[15] At least the Commission is bound by its own guidelines by which it limits its discretion.[16] Since they committed themselves to comply with the principles in the Notice through the Statement in the form of an Annex thereto[17] even the NCAs have bound themselves to adhere to these principles. It is therefore questionable that companies have no individual rights to challenge case allocation.[18]

B. Need for parallel leniency applications

The system of parallel competences in cartel cases triggers the necessity of parallel leniency applications at least in those Member States that could pursue the cartel, *i.e.*, which were affected by the cartel conduct.[19] The ECN Cooperation Notice explicitly states that the leniency application made to one authority does not count as an application to any other authority.[20] If for instance a leniency candidate only files an application with the Commission, but the Commission does not take the case, the applicant would not be protected in the Member States affected by the cartel if the relevant NCAs were to pursue the cartel. The same applies to the ranking of a leniency application: an applicant may be the first with the Commission but not with all relevant NCAs or *vice versa*.

If more than three Member States are involved it is always advisable to apply for leniency with the Commission. It cannot be ruled out that the Commission would take over jurisdiction at a later stage even if NCAs were to start the investigation. If in such a case a company had only applied for leniency with the relevant NCAs, it would have no protection under the Commission's rules. In addition, it would be in the applicant's interest that the European Commission takes jurisdiction, because it would be able to deal with the case (or at least certain aspects of it) more efficiently than different NCAs investigating. Strong arguments that the Commission would be the best placed authority to deal with and keep the case are available, if for instance a Member State affected does not have a leniency programme yet,[21] namely Malta and Slovenia,[22] or if according to one of the affected Member States' programme the company would not qualify for leni-

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15 In the view of other commentators, this flexibility ensures the most efficient enforcement: C. Gauer and M. Jaspers, *Designing a European solution for a "one-stop leniency" shop* (2006) ECLR 685, 685.Gauer/Jaspers view

16 Joined Cases C189/02 P, C-202/02 P, C-205/02 P to C-208/02 P and C-213/02 P *Dansk Rørindustri and Others v Commission* (ECJ 28 June 2005) 209.

17 Commission ECN Cooperation Notice 72.

18 M. Siragusa/C. Rizza (eds.), *EU Competition Law: Volume III: Cartel Law*, 2007 3.137; C. Canenbley/M. Rosenthal, *Co-operation Between Antitrust Authorities In-and Outside the EU: What does it Mean for Multinational Corporations?-Part 1* (2005) ECLR 106, 110.

19 C. Gauer/M. Jaspers, *The European Competition Network, Achievements and challenges – a case in point: leniency* (2006) EC Competition Policy Newsletter 8, 10.

20 Commission ECN Cooperation Notice 38.

21 D. Schroeder and S. Heinz. *Requests for Leniency in the EU: experience and legal puzzles*, in K. Cseres, M. Schinkel and F. Vogelaar (eds.), *Criminalization of Competition Law Enforcement* (Edward Elgar, Cheltenham, 2006) 161, 169.

22 Recently also Spain adopted a Leniency Program, which took effect on February 28, 2008.

ency, *e.g.*, as an instigator of the infringement under the German leniency scheme.[23] In that case the applicant might not come forward with his application, if the Commission did not take the case. It would nevertheless be advisable to file parallel national applications in all jurisdictions concerned that allow for leniency in order to be fully protected, because the company cannot rely on the Commission taking the case or keeping it in its entirety.[24] The recent confectionary investigation suggests that there is also a risk of parallel investigative measures of the European Commission and NCAs, which further highlights the need for the applicant to secure its rank in all jurisdictions.

C. Procedural and substantive problems in the past

Until recently the fact that some Member States did not have a leniency programme combined with the uncertainty about the case allocation discouraged potential applicants.[25] If the case were dealt with by the Commission the absence of a leniency programme in one of the Member States concerned by the infringement would not be an issue. If in contrast the case were dealt with by NCAs the applicant were not protected from sanctions in the Member State in which no leniency programme existed.

Lack of harmonization of the conditions for immunity also caused disincentives to make an application. Other authors have described this as a race to the top.[26] While in Brussels only applicants that coerced other companies to participate in a cartel were disqualified from immunity,[27] in some Member States, *e.g.*, in Germany a stricter standard applies, which means that (sole) ringleaders do not qualify for immunity.[28] Also, on the termination of the infringement, different standards applied.[29] While the Commission required the immediate termination of the infringement under the 2002 Leniency Notice,[30] the German regime is more flexible and allows coordination of the termination with the

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[23] Bundeskartellamt Notice no. 9/2006 on the immunity from and reduction of fines in cartel cases (the FCO Leniency Notice) available under http://www.bundeskartellamt.de/wEnglisch/download/pdf/06_Bonusregelung_e.pdf [3].

[24] According to M. Siragusa/C. Rizza (eds.), EU *Competition Law: Volume III: Cartel Law* (2007) 3.134, six leniency cases have been transferred from the Commission to NCAs under the 2002 Leniency Notice through the end of 2005.

[25] D. Schroeder and S. Heinz. *Requests for Leniency in the EU: experience and legal puzzles*, in K. Cseres, M. Schinkel and F. Vogelaar (eds.), *Criminalization of Competition Law Enforcement* (Edward Elgar, Cheltenham, 2006) 161, 166.

[26] C. Gauer and M. Jaspers, *Designing a European solution for a "one-stop leniency" shop* (2006) ECLR 685, 686.

[27] Commission Notice on Immunity from fines and reduction of fines in cartel cases (the Commission Leniency Notice) (2006) OJ C 298/17, 13.

[28] FCO Leniency Notice 3.

[29] C. Gauer/M. Jaspers, *The European Competition Network, Achievements and challenges – a case in point: leniency* (2006) EC Competition Policy Newsletter 8, 10.

[30] Commission notice on immunity from fines and reduction of fines in cartel cases (2002) OJ C45/3, 11(b); The new Commission Leniency Notice, however, allows to defer the termination of certain activities, e.g, attendance of meetings, in order to preserve the integrity of the inspections: Commission Leniency Notice 12 (b).

Federal Cartel Office, which is reflected in the wording that the participation in the cartel has to be stopped "at the Federal Cartel Office's request".[31]

In the absence of a marker system and a system of summary applications it was also a considerable burden to pursue full parallel applications in different Member States at the same time in order to secure the rank.[32]

D. Recent improvements through ECN Model Leniency Programme

The fact that today all Member States but Malta and Slovenia have a leniency programme has to some degree reduced the problems described above.

Another step forward has been substantive harmonization. Within the framework of the ECN, the Commission and the NCAs developed a Model Leniency Programme[33] that responds to the criticism leveled against the existence of different national leniency programmes within the EU, the resulting burden of multiple filings and sometimes even the elimination of the incentive to apply for leniency.[34] It is the result of a working group within the ECN that had the task to solve the most pressing problems of multiple leniency applications. The document was endorsed unanimously on September 29, 2006 by the heads of the NCAs, which also committed to use their best efforts to align their respective current programmes and future programmes to the ECN Model Leniency Programme.[35] This commitment does not prevent a competition authority from a adopting a more favorable treatment than envisaged in the ECN Model.[36] The document represents a soft-law harmonization tool. The ECN Model Leniency Programme sets out the principal substantive rules that the ECN Members believe should be common to all programmes and also provides for some basic procedural framework seeking to alleviate the burden of multiple filings by introducing a marker system and summary leniency applications. It is not a leniency programme of its own, but requires implementation by the different ECN members. If implemented in all Member States it will lead to a significant degree of harmonization of the main substantive and procedural requirements of leniency. So far only the European Commission and some Member States, *e.g.*, France, Germany, Belgium, the Netherlands, Italy, and Spain have adjusted their respective programmes to reflect the consensus of the ECN Model Leniency Programme. ECN members shall assess the state of such convergence in 2008.

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31 FCO Leniency Notice 7.

32 D. Schroeder and S. Heinz. *Requests for Leniency in the EU: experience and legal puzzles* in K. Cseres, M. Schinkel and F. Vogelaar (eds.), *Criminalization of Competition Law Enforcement* (Edward Elgar, Cheltenham, 2006) 161, 167; C. Gauer and M. Jaspers, *Designing a European solution for a "one-stop leniency" shop* (2006) ECLR 685, 686.

33 ECN Model Leniency Programme http://ec.europa.eu/comm/competition/ecn/model_leniency_en.pdf (the ECN Model Leniency Programme).

34 C. Gauer and M. Jaspers, *Designing a European solution for a "one-stop leniency" shop* (2006) ECLR 685, 686.

35 *Competition: the European Competition Network launches a Model Leniency Programme – frequently asked questions* MEMO/06/356, http://europa.eu/rapid.

36 ECN Model Leniency Programme 3.

I. Procedural Improvements

The ECN Model Leniency Programme introduces a uniform summary immunity application system for cases concerning more than three Member States, which only applies to immunity applications prior to inspections. Under this system, if a full immunity application has been made with the European Commission, NCAs can grant a "marker" and accept temporarily to protect the applicant's "place in the queue" on the basis of very limited information that can be given orally.[37] The NCA will not take any position on the application, but only confirm that the applicant is the first to file and that it will grant the applicant a period of time to complete the marker should the NCA later act on the case.[38] Unfortunately, a summary application at the European Commission is not possible, which would be helpful in cases where NCAs appear to be best placed to deal with a case, but a precautionary application in Brussels is needed in order to preserve the rank in the event that the case later gets transferred to Brussels.

Like the remainder of the ECN Model Leniency Programme, the system of summary leniency applications is voluntary and not automatically binding for NCAs. As of July 2007, 17 national regimes allow for summary applications.[39] If a summary application is not available (either because the NCA does not provide for one or because inspections already took place), the leniency applicant can still file full parallel leniency applications with the Commission and the relevant NCAs.

Also the introduction of a marker system, which allows the applicant to secure his rank without providing all the evidence from the beginning in a number of different countries at the same time, has alleviated the burden for the leniency applicant considerably, because he does not have to file a full-fledged application in a number of jurisdictions at the same time. However, a marker system is still less ideal than a one stop shop, because parallel applications continue to be required.

The ECN Model Leniency Programme also contains certain procedural elements that seek to increase legal security for the applicant, *e.g.*, when and how he is informed about his status.

The ECN Model Leniency Programme also allows for oral applications to be made,[40] which is relevant in order to avoid negative consequences of leniency applications in civil damage proceedings.

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37 ECN Model Leniency Programme 22.

38 ECN Model Leniency Programme 23.

39 "List of authorities accepting summary applications as provided by the ECN Leniency model programme in Type 1A cases", http://ec.europa.eu/comm/competition/ecn/accepting_nca.pdf. Since the last update Spain should be added to the list of the countries allowing summary applications.

40 ECN Model Leniency Programme 14.

II. Substantive harmonization

As far as substantive harmonization is concerned, the scope of the ECN Model Leniency Programme is limited to horizontal hardcore cartels only.[41] In this respect the harmonization went into the wrong direction. While the Commission Notice never covered vertical restrictions, several national programmes did.[42] Since vertical restrictions occur often as part of the implementation of horizontal cartels, the absence of coverage constitutes a disincentive for companies to apply for leniency.[43]

The ECN Model Leniency Programme does not cover the issue of individual or criminal sanctions. It specifies the conditions for immunity for companies prior to the dawn raid (1A Immunity) and after the dawn raid (1B Immunity) and clarifies which type of information the applicant has to provide. It also provides for some minimum harmonization of the conditions for an application for a reduction of the fine (Type 2) and limits the possible reduction to 50% in order to create an incentive to cooperative prior to the opening of an investigation by the authority.[44] However, the level of harmonization is more limited here, which makes sense, because the case allocation has already happened at this stage of the proceedings so that the applicant only needs to check the conditions for a reduction of the fine in the applicable regime but not in a number of different jurisdictions. For example, it is left open in the ECN Model Leniency Programme, whether the rank or the value added decided on the reduction granted. At the same time it clarifies the further conditions to obtain leniency, *e.g.*, cooperation throughout the duration of the proceedings, termination of the infringement, *etc.*, because lack of harmonization of these points in the different jurisdiction led to uncertainty and discouraged applicants. It also clarifies which category of applicant does not qualify for immunity due to their role in the cartel as coercer.

E. Remaining differences

Even if the ECN Model Leniency Programme is implemented by all ECN members as planned some important aspects that play a role in the assessment of whether to apply for leniency are not yet harmonized.

First of all, significant procedural differences are likely to remain in the different jurisdictions, which may have an impact on the decision whether to file an application or not.

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41 ECN Model Leniency Programme 4.

42 For examples, see D. Schroeder and S. Heinz. *Requests for Leniency in the EU: experience and legal puzzles*, in K. Cseres, M. Schinkel and F. Vogelaar (eds.), *Criminalization of Competition Law Enforcement* (Edward Elgar, Cheltenham, 2006) 161, 163.

43 While some commentators advocate leniency for vertical restraints, *e.g.*, D. Schroeder, *Kronzeugenregelungen im Kartellrecht*, in I. Brinker, D. Scheuing and K. Stockmann (eds.), *Recht und Wettbewerb Festschrift für Rainer Bechtold zum 65. Geburtstag* (C.H. Beck, Munich, 2006) 437, 445; the ECN Model Leniency Programme consciously excluded them: See ECN Model Leniency Programme: Explanatory Notes http://ec.europa.eu/comm/competition/ecn/model_leniency_en.pdf p. 14.

44 ECN Model Leniency Programme 11.

A marker is only available in Brussels for the immunity applicant and not for an applicant for a reduction of the fine,[45] whereas in Germany a marker is also available for both immunity and reduction of the fine applicants.[46] The marker is also discretionary in Brussels, which means that an applicant does not really know whether he will be given more time to substantiate his application or whether he will be judged by his input at the time he approaches the Commission.[47] First experiences with the marker system in Brussels appear to suggest that the Commission is in particular not willing to give a marker in cases, where NCAs have already taken investigative measures. Such a restrictive approach discourages applicants from approaching the Commission and disclosing the full geographic scope of the infringement.

In Germany, the marker will normally be given by the FCO and protects the applicant even if other applicants provide more evidence after the applicant has set the marker but not yet substantiated it. The German system is favorable, because it encourages the applicant to approach the authority at an early stage, which lowers the psychological threshold for the applicant and allows the authority to influence the internal investigation with a view to manage the risk of information leakage. Also the information provided by the competition authorities on the availability of immunity and the rank of the applicant differ in practice.

The timing required by the different competition authorities for substantiating the leniency application after setting a marker also differs from jurisdiction to jurisdiction. For example in Germany, the FCO has put a fixed maximum deadline of 8 weeks into its leniency notice.[48] In other jurisdictions, *e.g.*, in Brussels, the time will be determined on a case-by-case basis. In that respect the Brussels system is preferable and it appears that in practice the deadline in the German notice is handled with more flexibility.

Also different standards of evidence are likely to be applied from jurisdiction to jurisdiction based on what proof is required under national law for the infringement.

In addition, the procedural framework will remain different, *e.g.*, rules on access to the file, the respective competition authority's approach to settlement, *etc.* Also the oral procedure is in practice often not respected by some NCAs.

Also differences in the civil legal systems are relevant for a leniency applicant. He may be reluctant to file a leniency application in a given Member State because of a high risk of civil damage claims in that jurisdiction. The risk of private damage claims in a particular jurisdiction depends on elements of discovery in procedural rules, the willingness of the competition authority concerned to give access to the file.

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45 For reasons for the decision not to grant a marker for reduction applications on an EU level, see: S. Suurnäkki/M. Tierno Centella, *Commission adopts revised Leniency Notice to reward companies that report hard-core cartels* (2007) EC Competition Policy Newsletter 7, 10; for opposing arguments see: J. Sandhu, *The European Commission's Leniency Policy: A Success?* (2007) ECLR 148, 153.

46 FCO Leniency Notice 11.

47 In the Commission's view, this uncertainty maintains the race between companies to provide evidence and information and facilitates the detection and termination of infringements, see: S. Suurnäkki/M. Tierno Centella, *Commission adopts revised Leniency Notice to reward companies that report hard-core cartels* (2007) EC Competition Policy Newsletter 7, 9, while in other commentators views, this uncertainety deters applicants, see: J. Sandhu, *The European Commission's Leniency Policy: A Success?* (2007) ECLR 148, 150.

48 FCO Leniency Notice 12.

Also on substance, some differences will likely remain, because under the ECN Model Leniency Programme, NCAs are free to apply more generous rules to reward the whistleblower.[49] Such a competition for applications is desirable, because it stimulates the discovery of infringements.

However, in some instances national programmes fall short of the ECN Model Leniency Programme and apply a stricter test. For example, the German Leniency Notice, which adopts most of the ECN model, does not allow immunity from fines for a sole ringleader, which is not in line with the coercer test adopted in the ECN Model Leniency Programme.[50] This is not a welcome development, because it undermines the success of the soft harmonization undertaken by the ECN members.

The fact that sanctions against individuals are not covered by the ECN Model Leniency Programme, which can be explained by the fact that not all jurisdictions provide for sanctions against individuals, *e.g.*, the Brussels regime, is unfortunate, because the incentives of individuals to co-operate are crucial in enabling a company to apply for leniency. Without the co-operation of the individuals the company does not have any choice. Therefore, the absence of harmonization in the treatment of individuals concerned somehow weakens the effects of the harmonization achieved with respect to the treatment of companies. Also the availability of immunity in the context of additional criminal prosecution should be harmonized.

As far as applications for reduction of the fine are concerned, the ECN Model Leniency Programme leaves a lot of discretion. The differences between the European Leniency Notice and the German Leniency Notice show some of the possible differences. One question is the ranking of applications behind the immunity candidate, in Europe fixed percentages apply depending on the rank, whereas the German programme leaves room for flexibility with respect to the amount of the reduction.

In summary, the ECN Model Leniency Programme (provided that it is implemented as planned) is a great achievement, because within a very short timeframe it has solved a number of the problems associated with multiple leniency applications. However, some further steps may be required to make the system of parallel competences as efficient as a one stop shop. It would be helpful if there were a one stop registry for applications in Brussels with the possibility for the Commission to delegate jurisdiction to NCAs. Such a registry would avoid the burden of parallel applications, but would leave room for case allocation within the ECN.

As far as the seminar's topic "systems competition" is concerned it can be concluded that competition between different leniency programmes without any harmonization would only be a good idea, if the applicant could choose the competition authority that will deal with the case. Since the ECN members decide on case allocation and even claim that there is no rights of the companies concerned to claim judicial review of the allocation, only a certain level of harmonization can ensure the attractiveness of applying for leniency. Having achieved a minimum standard through the ECN Model Leniency Programme competition between competition authorities for applicants by offering lower standards than the common standard remains desirable.

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49 ECN Model Leniency Programme 3.

50 FCO Leniency Notice 3.

Exporting Competition Policy: From Soft Pressures to Shared Values

Andreas Weitbrecht[*]

Given the overall topic of our Symposium – International Economic Law as an Economic Good – this contribution will address competition policy as an export good. Competition policy becomes an export good in three different ways:

- Competition policy is exported from one state into another by way of legislation of the importing state adopting standards similar to those of the exporting state.
- Secondly, domestic competition policy can be exported abroad by way of administrative enforcement of domestic law in the international sphere under the effects principle.
- Finally, harmonisation of competition policy is but another form of – multilateral – export. Accordingly, this contribution would not be complete without some thoughts on the harmonisation of competition policy.

A. Competition policy as an export good in the legislative sphere

Overall, competition policy has been a very popular export item over the course of the years. This section will briefly describe the most important instances in which competition policy has been exported, will discuss the motives for exporting and importing competition policy and will conclude with some comments on the reformulation of competition policy in the importing state.

I. History

Antitrust law – and this term will be used synonymously with competition law, a term which has gained acceptance in Europe and the rest of the world – was, as is well-known, invented in the United States on the basis of some relatively vague precedents in the common law.[1] In 1890, the Sherman Act was enacted by the US Congress as part of a movement to combat evil forces of "Trusts" and 1914 saw the enactment of the Clayton Act. Section 1 of the Sherman Act makes unlawful any conspiracy in restraint of trade whereas Section 2 makes illegal the monopolisation of markets; Section 7 of the Clayton Act extends this prohibition to mergers which tend to substantially lessen competition.

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[1] See E. Gellhorn/W. Kovacic/S. Coltins, *Antitrust Law and Economics* (5th edition 2004) 1-16.

For more than 50 years, the Sherman Act was not the subject of any movement to export its contents to another country. Instead, based on ideas that had developed in Vienna in the 1890s in Europe the first modern competition laws were enacted in the 1920s, most importantly in Germany. These laws centred on giving administrative agencies the authority to intervene in cases in which individual companies or cartels were abusing their economic power. These laws were of limited effect and in any event they did not provide for a blanket prohibition of cartels, representing a strand of competition law that was independent of US influences.

After the close of the Second World War, the United States made sure that the countries they had defeated, most notably Germany and Japan, would enact a competition law along the lines of US antitrust law. Japan did so, but did not enforce its laws until the latter part of the 1980s. As regards Germany, the US enacted in the zone of Germany which they controlled the first US style competition law. And it was understood that the newly created state of West Germany should also enact a competition law. This process lasted from 1949 to 1956 and ultimately led to the enactment of the German competition law in 1957 which entered into force on 1 January 1958.

The German policy and law were influenced not only by the US but also by a second, completely independent source, the "Freiburg School". This group of economic and political thinkers was led by scholars teaching at Freiburg University, e.g. Franz Böhm and Walter Eucken and included Germany's first economics minister, Ludwig Erhard, and Walter Hallstein, who would later become the first president of the European Commission. According to these "ordoliberals", the establishment of a competition law was an important part of the "Economic Constitution", which apart from competition law included the freedom to conclude contracts enforced by the courts and the guarantee of property rights and which insured the economic freedom of action of every actor.

At the same time, i.e. at the middle of the last century, the example from the US also influenced the founding fathers of the European Union. As a result, the European Coal and Steel Treaty, enacted in 1951, in Articles 65 and 66 contained not only rules similar to Section 1 and Section 2 of the Sherman Act but also merger control provisions resembling those of the Clayton Act.

The American policy and the European Coal and Steel Treaty in turn influenced the founding fathers of the Rome Treaty. In addition, by the time the Rome Treaty was being drawn up in 1955 and 1956, Germany was about to conclude the legislative process for its national competition law described above; indeed, both the Rome Treaty and the German competition law came into force on the same day, 1 January 1958. The fact that the Rome Treaty – unlike the European Coal and Steel Treaty – did not include rules on merger control is probably due to the German influence since Germany had concluded at the time that for its own national competition law it did not need to have a substantive merger control provision.[2] As the only member state that had a national competition law remotely resembling that of the EEC, German thinking was to become very influential in EEC competition law and policy for many years to come.

While these developments have been extensively described and documented,[3] the multitude of influential forces through which competition policy was subsequently ex-

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[2] Substantive merger control was established in Germany only in 1973 by the Second Amendment to the competition law.

[3] See the seminal study by David J. Gerber, *Law and Competition in 20th Century Europe: Protecting Prometeus* (1998, paper back edition 2001).

ported within the EU have not been documented nearly as well. Only a few strands can be mentioned here: When in 1989, the EU finally enacted a Merger Control Regulation, it borrowed from Germany the all important substantive test, whereby the Commission could intervene where a merger created or strengthened a dominant position.[4]

During much of the 1990s, the EU exported its competition policy to its Member States, most of which did not dispose of a competition law at the time. As a result, today most Member States have a competition law which very much resembles that of the EU. The enactment of Regulation 1/2003, requiring the authorities and courts of Member States to apply Articles 81 and 82 EC in all cases beyond those that are of purely local significance, has provided the final building block for uniformity among national competition laws, leading even Germany to largely harmonise its competition law with that of the European Union.[5]

When in the early 1990s, the former East Block countries entered the transformation process from state-run economy to market economy, the EU and its Member States exported their competition policy to the former East Block nations. And countries aspiring to becoming members of the EU must, as a part of the conditions for membership, show that they have enacted and begun to enforce competition rules modelled on the EU.

Other export relationships are less widely known. E.g. the OECD has played and continues to play an important role in proliferating competition policy around the world. Likewise the United Nations and its subsidiary organisation UNCTAD have contributed to the spread of competition policy, even though this influence may at thetime have been obscured by the emphasis, due to the post-decolonisation period, on state sovereignty over natural resources and the like. The most influential forum today is undoubtedly the International Competition Network (ICN) which is based on a nonbinding interagency agreement and informal interaction among the agencies.

In any event, today a large number of countries have adopted a competition policy embodied in competition laws that are quite vigorously enforced. The list of countries includes most notably but is certainly not limited to Korea, Argentina, Brazil, Mexico, South Africa, and China.

II. Motives for the exporting and importing of competition policy

If one inquires into the motives why competition policy was exported from the US to Japan and Germany and the EU and subsequently from these jurisdictions elsewhere in the world, one can view this process from two sides: from the point of view of the exporting country as well as from the point of view of the importing country – no export transaction will take place if there is no buyer in the importing country.

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4 More recently, this test was abolished by the new Merger Regulation 139/2004 in favour of a test influenced by the American and British example calling for intervention where a merger significantly impedes effective competition in the Common Market (SIEC test).

5 7th Amendment to the Act against Restraints of Competition of 2005. In line with Regulation 1/2003, the harmonization did not extend to merger control.

1. Seen from the exporting state

The motives of the US, when exporting their competition policy to post-war Japan and Germany, were at least in the case of Germany clearly not only economic but also political in an attempt to make sure that the Nazi Regime would not be repeated and that the post-war Germany would be more akin to the American nation.

When the US, ultimately with some success, managed to convince the Japanese to not only adopt but to enforce a competition law worthy of that name, their motive was very much to discourage the formation of national champions and cozy relationships among Japanese national champions in their own home country, which would allow Japanese companies to use supra-competitive profits made at home to enter, using a predatory pricing strategy, the US market.

The ultimate success of the US effort coincides with the "Strategic Impediments Initiative", launched by the US in the late 1980s. This initiative sought to have Japan, by more vigorous enforcement of its own competition laws, intervene against domestic distribution networks that were denying foreigners the opportunity to participate in those distribution networks, thereby raising the costs of foreign rivals which would need to construct their own distribution network from scratch.

As a general proposition, to the extent that such issues arise between states, they are addressed by the antidumping laws. In particular, under WTO law, there is no obligation of any state to ban and intervene against restrictive business practices in its own territory. This has been confirmed by the *Kodak-Fuji* case.[6] That being said, where the local government is involved in the restrictive trade practices that obstruct imports a remedy at the WTO level may lie.

2. Seen from the importing state

Apart from the two well-known instances of Japan and Germany following the end of World War II, political pressures have not been documented. To be sure, the OECD lobbies members and prospective new members to enact and enforce competition laws that are evenly applied against domestic and foreign champions. But IMF conditionality, ie the policy prescriptions which were tied by the International Monetary Fund to the granting of loans, never seems to have included an express requirement to adopt and enforce competition policy.

Why, then do states agree to adopt an antitrust policy as a good that they are willing to import and have more or less actively enforced through domestic agencies? As can be seen in the case of Germany and Japan, political pressures from abroad may have played a significant role in the past. Indeed, the adoption of a competition law may well be the result of foreign influence as well as domestic wisdom. However, as regards the enforcement of an existing competition law, political pressure from abroad, which cannot be maintained ver a prolonged period of time, will not suffice.

Rather, importing countries appear to have ultimately been motivated by a realisation that economic liberty and vigorous competition are one of the most important factors

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6 *Japan – Measures affecting consumer photographic film and paper*, WTO panel report of 31 March 1998, WT/DS44/R. See K. M. Meessen, *Economic Law in Globalizing Markets* (2004) pages 134 et seq.

contributing to of a thriving economy. There is much to be gained and little harm to be suffered from adopting a competition policy and law following the mainstream.

III. The reformulation of competition policy in the importing state

Most competition laws are very similar with respect to the subject areas that they address. As the US law, they tend to rest on three pillars:

- agreements and concerted practices that restrict competition, including hard-core cartels,
- monopolisation/abuse of dominant position,
- mergers.

However, there is a considerable margin of discretion for the domestic legislator and, even more importantly, for the domestic enforcement agency to graft its own competition policy on to whatever laws have been enacted. Among these three pillars, the prohibition of and fight against hard-core cartel, i.e. price-fixing, allocation of customers and markets, reduction of output and bid-rigging by competitors, is so pernicious in its effects and devoid of any redeeming social or economic value that it tends to be universally condemned; there is, however, no consensus yet as to the appropriate remedy and sanction, be it criminal sanctions against individuals, including imprisonment, administrative fines or private damage claims.

The picture is different as regards abuse of dominant position and merger control. Here different policies can be pursued and are being pursued within seemingly similar legal frameworks.

Without as much as a single change in the wording of the underlying statutes, the United States in the second half of the 1970s underwent a complete antitrust revolution. The Chicago School taught that antitrust law should be concerned not with bigness of corporations or fairness for everyone, but should rather be limited to ensuring efficiencies of scale and scope and consumer welfare.[7] This thinking today, again without any change in the EU Treaty, has been adopted by the European Commission which proclaims a standard of consumer welfare as the guiding goal of EU competition policy.

Thus, once adopted into the domestic law of a particular nation or supranational organisation, competition policy will take on a life of its own. It was not the difference in wording between Section 2 of the Sherman Act and Article 82 EC which lead to opposite results when the US and EU respectively dealt with the monopoly that Microsoft enjoys in PC operating and application software.[8]

Similarly, and perhaps even more importantly, in the field of merger control one can pursue various policies, in particular not only competition policy as we know it but also to control foreign investment and to implement an industrial policy fostering national champions. The way in which the respective merger control regimes are enforced in Russia, China and other countries may serve as examples.

Thus, the popularity of seemingly homogeneous rules of competition law as an export item – the three pillars – tends to mask somewhat the differences in actual application by the local authorities that are revealed upon clever analysis.

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7 See Robert Bork, *The Antitrust Paradox* (1978).

8 For a description of the case, see below B.I.1.

B. Exporting competition policy by way of administrative enforcement

The second aspect of exporting competition policy, by way of administrative enforcement, is somewhat less obvious. It is a kind of exporting of competition policy by force, but again it requires some degree of acceptance of the recipient state.

I. Examples

Three recent examples will illustrate how this sort of export works in practice:

1. Microsoft

The European Commission, in 2004, concluded that Microsoft had abused its unanimously accepted dominant position by bundling the Windows Media Player with the Windows Operating System and other applications for which Microsoft enjoys a virtual monopoly.[9] According to the Commission, a second abuse was Microsoft's refusal to reveal to competing software companies the source code required for these competitors to develop competing software – i.e. competing with Microsoft – for the operation of work group servers.

This decision by the European Commission was upheld on 17 September 2007 by the European Court of First Instance[10] and Microsoft has subsequently decided not to appeal this judgment and instead to change its business practices in order to comply with the European Commission's decision.

Owing to the global standardisation of both hardware and software for PC systems, this change of business practices, introduced solely in order to comply with the European Commission's decision, is not limited to the territory of the EU; instead it affects Microsoft's business practices worldwide, even though the US courts had previously concluded that Microsoft's business practices were largely legal under the laws of the United States, Microsoft's home country.[11]

What in effect has happened is that the European Union has exported its competition policy to the rest of the world. The United States did not protest against the European Union's assertion of – worldwide – jurisdiction, based on the effects principle.

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9 *Microsoft* (Case COMP/C-3/37.792) Commission Decision of 2004, published on the Commission's website; summary Commission document 2007/53/EC (2007) OJ L32/23.

10 Case T-201/04 *Microsoft v. Commission* (CFI 17 September 2007).

11 See for example *United States v. Microsoft Corporation* 253 F.3d 34 (D.C.Cir. 2001) (US Court of Appeals for the District of Columbia).

2. GE/Honeywell

Prominent examples can also be found in the area of merger control. Perhaps the best-known example is the prohibition, again by the European Commission, of the merger between General Electric and Honeywell in 2001.[12] By whatever yardstick is being used, this combination would at the time have been the largest industrial merger ever. The Commission's prohibition was upheld in December 2005 by the European Court of First Instance, even though the Court had found serious issues with a considerable part of the Commission's reasoning.[13] However, the merger had been cleared in early 2001 by the competition authorities in the United States, the home country of both General Electric and Honeywell.

At the time the European Commission's prohibition decision was handed down on 3 July 2001, General Electric had in fact lost interest in pursuing the merger with Honeywell. As a result, the reaction of the United States to the assertion by the EU of worldwide jurisdiction was far more muted than it would have been if General Electric had still been seriously pursuing the merger with Honeywell. Nevertheless, even if the full force of General Electric had been behind the protests from the United States, it is highly likely that the prohibition by the European Commission would have prevailed.

3. Four prohibitions of international mergers by the German Federal Cartel Office

More recent examples can be found in Germany, where between October 2006 and September 2007, the German Federal Cartel Office prohibited four mergers that concerned exclusively – and on both sides – foreign companies; the only nexus to Germany was the fulfilment of the thresholds of the German merger control law and – in some cases – the presence of sales forces.[14]

Two of these mergers occurred in worldwide markets and, in at least one case involving two American companies, the merger had been authorised by the US Agency competent to deal with the merger. In another case, involving at least EU-wide markets, the German prohibition stood in contrast to clearances from the Spanish and Austrian authorities. The fact that markets were considered to be geographically worldwide or EU-wide means that, assuming that competition laws and policies are identical, each enforcement authority should come to the same view on the particular merger.

It is remarkable that none of these cases before the German Federal Cartel Office led to diplomatic protests against Germany from the foreign nations involved. Under these circumstances it is difficult to argue that the prohibitions violated public international law. In fact, they are problematic not so much from a public international law perspec-

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12 *General Electric/Honeywell* (Case COMP.M/2220) Commission Decision of 3 July 2001, published on the Commission's website and as Commission document 2004/134/EC (2004) OJ L 48/1.

13 Case T-210/01 *General Electric v. Commission* (2005) ECR II-5575.

14 B 7 – 97/06, 25.10.2006 – *Coherent/Excel Technology*; B 5 – 10/07, 14.02.2007 – *Sulzer/Kemix/Werfo*; B 3 – 578/06, 11.04.2007 – *Phonak/GN ReSound*; B 5 – 51/07, 24.08.2007 – *Cargotec/CVS Ferrari*. In case one of the parties has production facilities in Germany, they can be divested and often this will serve the problem.

tive, but from a perspective of German domestic law, in particular because they cut against the constitutionally protected freedom of companies to merge, which extends to foreign markets as well as to the domestic German market.[15]

II. The most interventionist state prevails

What all of these cases have in common is the fact that ultimately the jurisdiction that intervened against the business practice or merger was able to prevail with its view over other more permissive jurisdictions. This result is due to the vulnerability of multinational companies in every jurisdiction in which there doing business and which they cannot afford to give up. In none of these cases did the intervening jurisdiction need to enforce its decision.

Ultimately, the most interventionist state can only prevail because these decisions, enforcing anti-trust laws somewhat more strictly than other states have done, are still acceptable and are an emanation of almost universally shared values in competition and enforcing competition policy. In fact, since several waves of exporting competition policy to other countries have made competition policy universal, the basis for resisting the application in this particular case has become much more tenuous. It has been a long time since blocking and claw back statutes were brought to bear against the "extraterritorial application" of competition law. Thus, the exporting of competition policy that lies in the unfettered application of the effects principle today appears, in probably a vast majority of cases, to be a completely acceptable standard of assuming and exercising jurisdiction under public international law.

C. Harmonisation

When viewing the various strands of development over more than fifty years, that have been summarised in the first section of this chapter, it becomes apparent that what began as a rather crude exporting of US antitrust policy into foreign nations has for some time now become an almost universal force of competition policies cross-pollinating each other around the globe.

I. The failure of top down harmonisation

What we see today is not the result of harmonisation efforts in the classical sense. The drafters of the Havana Charter of 1948, the predecessor of the GATT, had provided for a section on competition law, which, however, never was adopted.[16] Further attempts to establish universally accepted rules of competition law by the Economic and Social Council of the UN (ECOSOC), by GATT itself and by UNCTAD were either not for-

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15 Andreas Weitbrecht, *Völkerrecht und Kollisionsrecht in der deutschen Fusionskontrolle – Zur Untersagung von Auslandszusammenschlüssen durch das Bundeskartellamt*, in Festschrift für Rolf Birk (2008) 977.

16 Articles 46-52 Havana Charta for the International Trade Organisation (24 March 1948).

mally adopted (ECOSOC and GATT)[17] or were adopted but displayed little practical significance (UNCTAD)[18]; even less practical significance was accorded to the draft International Antitrust Code that has been compiled by a group of eminent competition and trade law experts in Munich in 1993.[19]

Harmonisation of competition laws was also a topic of the WTO negotiations in the Doha Round and contributed to the failure of the Cancun Conference in 2003.[20] Apart from the success that the supranational harmonisation of competition laws under the auspices of the European Union enjoyed, all efforts make uniform competition policies by way of a *top down* harmonisation of substantive rules have failed.

II. Soft convergence

The failure of any efforts at harmonisation stands in stark contrast to the actual proliferation of substantially similar competition laws. Today's harmonisation of standards mostly takes place in the International Competition Network (ICN). A harmonisation by way of international trade instrument is neither necessary nor desirable. Harmonisation within the ICN is based on shared values about the benefits of competition vs. state intervention in the economy and has made conflicts over the appropriate enforcement of domestic antitrust laws in the international sphere much less dominant than they were in the one hundred years following the enactment of the Sherman Act.

D. Summary and Conclusion

When viewing the entirety of these developments, one finds that competition policy has become an extremely popular export item: even where originally its export may have been accompanied by soft pressure and only grudgingly accepted by the importing state, over time even states such as Japan have begun to understand the benefits of a circumspectly enforced competition policy. The fact that the recipient state, once having imported competition policy into its domestic law, can reformulate and shape competition policy according to its own political choices, has clearly contributed to the popularity of competition policy as an export good, to the point of masking any differences as to the identity of the item that has been exported/imported.

A similar development can be seen in the application of the effects principle: whereas early assertions of the exercise of jurisdiction under the effects principle met with resistance from other states, the assertion of jurisdiction, based on substantial domestic effects, is today almost universally accepted, even where the remedy in the particular case cannot

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17 K. M. Meessen, *Völkerrechtliche Grundsätze des Internationalen Kartellrechts* (1975) at page 37 et seq.

18 See P. Kather, *Der Kodex der Vereinten Nationen über wettbewerbsbeschränkende Geschäftspraktiken* (1986).

19 See W. Fikentscher, *Competition Rules for Trade Agents in the GATT/WTO system* (with Annex containing draft Code, 49, Außenwirtschaft 281 (1994).

20 K. M. Meessen, *ICN Accompanied Convergence, Instead of WTO Imposed Harmonization, of Competition Laws* (Cambridge University Press).

be limited to the intervening state. This acceptance is based on the fact that most states value competition policy as an economic good, sharing the values of free competition in the private sector.

The preferred way to move forward in this front today is by way of soft harmonisation that takes place under the auspices of the International Competition Network. This preserves the competition of systems while at the same time eliminating the most obvious frictions that result from substantive divergences between the respective substantive competition laws.

Part 3
Venues of Systems Competition

Chapter 1
World Trade Organization

Where Trade Policy Stands Today

Richard Senti[*]

A. Introduction

In September 1986, Julio Maria Sanguinetti, then President of Uruguay, opened the Eighth GATT Round by saying: "We have to decide whether we are going to promote active and vigorous trade with equal opportunities for all, or whether we will choose the path of trade wars."[1] Seven years later, Peter Sutherland, then Director General of GATT, closed the Uruguay Round by stating : "The world has chosen openness and cooperation instead of uncertainty and conflict."[2]

Today, we find another round of trade negotiations in progress, the first WTO Round commenced in Doha in 2001. And similarly we find the Director General of the WTO, Pascal Lamy, issue a warning about a possible failure of the negotiations: "All of us would pay. We would pay through lost opportunities to expand trade […]. We would pay too, through a weakening of the multilateral trade system in favour of far less effective bilateral trade deals […]. Yes, we would all pay for this failure."[3] However, in contrast to the Uruguay Round, which was successfully concluded, the prospects for the Doha Round look bleak. What factors have led to this crisis – and indeed the current situation does amount to a crisis – at the WTO? Has the international economic order created by the operation of the GATT and the WTO over the past half century merely established a general framework or has it brought about improvements in the competitive order between states? Have the markets concerned been able to benefit from their comparative advantages due to liberalisation and, in turn, has this led to an increase in economic wealth and prosperity? Will the prevailing world trade order bring about its creators ambitions that „more ships will sail with fuller cargoes, more men will be employed, more goods will be produced, and more people will have better things to eat and wear and otherwise consume"?[4]

B. Thematic Delineation and Assumptions

In the following, distinctive characteristics of individual policy areas are examined with a view to subsequently addressing the question of how these developments will impact on the future of trade in goods and services. The present study will not address international capital markets, international labour markets, human rights issues and the various con-

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1 GATT (1986), 41/7.

2 GATT (1993), 104/1.

3 Lamy (2006).

4 USDA (1945), p. 4.

ventions on labour laws, child labour, wage compensation, equal opportunities etc. The analysis posits the assumption that the global economy will continue to perform similar to current levels, that large scale natural disasters, crop failures and pandemics do not occur and that overall security levels remain stable, that is to say that there are no new wars or large scale terror attacks.[5]

C. The Perspective

Currently, the WTO is undergoing structural changes which will shape the future world trade order and, as a result, the international competitive order. First, market power is partly shifting away from the US and EU to emerging markets. Second, the most recent free trade agreements, whose objectives go far beyond the WTO, are opening up a new dimension for the future trade order. Third, a vicious circle seems to be emerging between the WTO and regional free trade agreements whereby the lack of progress at the WTO leads to more regional agreements being concluded, which, in turn, weakens the global trade order. Fourth, the principle of reciprocity, enshrined in the WTO, is leading to the re-emergence of age-old mercantilism, albeit disguised. Fifth, in many countries, international trade policy is being used as a residual tool for domestic redistribution policies and political opportunism. Sixth, non-governmental organisations (NGOs) are increasingly questioning the WTO's legitimacy as a governing body.

D. Shifting of Market and Negotiating Power

During the early years of the GATT, one-quarter of all world trade fell upon the US. Since that time, this share has dropped to less than 10 percent. For a while, the US's decreased share was inherited by Europe. Today, these shares are taken on by Asian trading nations. In 2005 (most recent data available) the shares of China, Japan and India reached 15 percent of overall world trade.[6] A large proportion of Asian trade volume can be traced back to US and European investments in Asia, to the relocation of production to countries such as China. However, this too is an expression of and the result of a shift of market power to Asia. It appears as if this structural shift has not yet been completed. The OECD and the FAO have forecast annual growth rates of between 2 and 3.5 percent for the US and Europe between 2000 and 2015, while China and India are forecast to grow by between 5 and 10 percent annually.[7]

This shift in market power can be traced back to GATT and WTO trade negotiations. Immediately after World War Two, the US tabled its "Proposals for Expansion of World Trade and Employment" which was the first draft of a suggested new world trade order, based on the "Reciprocal Trade Agreements Act 1934" ("Cordell Hull-Programme"). The US also put forward a "Suggested Charter for an International Trade Organisation".

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5 These assumptions are in line with those made by the OECD and the FAO in the Outlook 2006-2015. OECD-FAO (2006), p. 14-33.

6 WTO, International trade statistics (annual), Tab. II.2 and Tab. II.3.

7 OECD-FAO (2006), Tab. A1, p. 112.

Further, the US determined which countries were invited to join the negotiations.[8] Invited countries largely acceded to the US proposals, European countries as a result of US post-war aid and the ten developing countries due to a lack of alternatives.

In the meantime, US pre-eminence in matters of trade policy is increasingly being questioned. In the run-up to the Singapore Ministerial Conference in 1996, the US suggested expanding trade negotiations to cover areas such as health, labour and the environment. However, South-East Asian nations successfully blocked such efforts. It was said that the US's endeavours were nothing more than a new form of protectionism designed to push developing countries out of world markets.[9] Similarly, the US was not able to prevail during the subsequent conferences in Seattle (1999) and Doha (2001). US proposals to discuss labour and employment issues in future negotiations were categorically rejected by developing countries. Immediately after then-President Bill Clinton's speech at the Seattle conference, India demanded that the issue of social provisos be removed from the agenda. As a result, the US proposals are no longer being discussed within the WTO context.[10]

Based on these developments, one has to assume that the future world trading order will see a further shift of market and negotiating power away from industrialised nations and towards emerging markets. This structural shift may result in to effects: On the one hand, the removal of individual states' predominance may lead to increased competition. On the other hand, there is a danger that nations in such a competitive relationship will obstruct further liberalisation of world markets.

E. New Dimension of the World Trade Order

The GATT and the WTO have for decades focused on a reduction of tariffs. Accordingly, this endeavour has proved largely successful. While industrial tariffs in Western countries stood in the region of 40 to 50 percent after World War Two, current levels average between 2 and 5 percent. The GATT and WTO have been less successful in the area of international trade in agriculture. Protectionism in the agricultural sectors mostly remains at the levels seen 50 years ago. Similarly, not much has changed in respect of the WTO's trade policy orientation. The report on trade in non-agricultural products, presented by Don Stephenson as part of the final negotiations of the Doha Round in the summer of 2007, deals almost exclusively with tariff reduction, the so-called "Swiss Formula", the delineation of products subject to customs duties, bound tariffs, preferential customs duty rates and tariff escalation.[11] Tariff reductions also stand at the centre of the

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8 See Brown (1950), p. 56.

9 NZZ, 23 July 1996, No. 169, p. 23.

10 According to the „Swiss formula", higher tariff rates are to be reduced above average; tariff bindings mean that reductions which are agreed and are registered with the WTO cannot be rescinded; preferential tariffs are customs duties which favour economically weaker states; escalating tariffs means that higher tariffs are charged where goods are subject to additional processing, while primary and preliminary products are subject to lower tariffs, in other words, the duty is paid on the value added. See Senti (2006), p. 78, including further reading.

11 Non agricultural market access (NAMA) text: http://www.wto.org/english/tratop_e/markacc_e/markacc_chair_texts07_e.htm (last viewed August 2007).

report on agriculture, ranked according to different product categories and countries.[12] Both reports are stuck in the past and do not offer any new ideas. They deal neither with the Singapore issues (Investment, Competition, Transparency in Government Procurement and Trade Facilitation), nor with rules of origin (RoO), safeguards, antidumping or revisions in the area of economic integration (Article XXIV GATT).

In contrast to the world trade order envisaged by the WTO, the numerous new free trade agreements go beyond the realm of mere tariff reductions and regulate, on a regional basis, issues such as rules of origin (see e.g., ASEAN-China Agreement, Singapore-India Agreement, Thailand-Australia-New Zealand-Agreement etc.), safeguard measures (see e.g., Singapore-United States Agreement, Singapore-Chile-New Zealand Agreement etc.), additional antidumping and countervailing duty measures (see e.g., Singapore-New Zealand Agreement).

Therefore, as a second conclusion, one is led to assume that the most recent regional free trade agreements, which transcend mere tariff reductions, are taking the future world trade order into a new dimension. This new dimension evidences a weakening of efforts to harmonise and internationalise world markets, a growing division of world markets into regional markets and, as a result, a decline in competition between WTO members.

F. WTO and Free Trade Agreements: A Vicious Circle

The original GATT pursued the objective of opening up existing areas of economic integration and preventing new preference systems from emerging. Thus, the outcome of negotiations was ambivalent. On the one hand, developing countries' demands for a system of preferences became ineffective with the demise of the International Trade Organisation (ITO) (Article 15). On the other hand, Article XXIV of the GATT was expanded to cover free-trade areas. In the original agreement there was only mention of customs unions. At that time, the negotiators either did not foresee, or simply ignored, that within a few decades a large share of world trade would be conducted within and between areas of economic integration.

The first economic integration areas of the GATT era were the European Communities (EC), the European Free Trade Association (EFTA) and the Central American Common Market (CACM), which emerged in the 1950s and 60s. During the Tokyo and Uruguay Rounds, a further 10, respective 38, such free trade areas materialised. However, the most such bilateral and regional agreements have been concluded during the Doha Round, a total of 136.

The emergence of so many free trade areas can be attributed to two factors. The first factor, as Robert Baldwin demonstrates in relation to the US, concerns the lack of progress within the GATT and WTO contexts. In 1982, after the EC and developing countries rejected US proposals for new GATT negotiations, the US turned to bilateral agreements in order to attain its aims and objectives autonomously. Subsequently, the US signed trade agreements with the Caribbean states, Israel and Canada as well as with

[12] Agricultural text: http://www.wto.org/english/tratop_e/agric._e/chair_texts07_e.htm (last viewed August 2007).

Canada and Mexico (NAFTA).[13] Similar to the effect that the unsuccessful Ministerial Conference of 1982 had, the prolonged Uruguay Round negotiations, the failed Seattle and Canún conferences and the yet to be concluded Doha Round have led to the adoption of regional integration agreements. Second, a domino effect has ensued. These free trade agreements are "like street gangs, you may not like them, but if they are in your neighbourhood, it is safer to be in one".[14] For instance, some industries in the EU are demanding that the EU Commission enter into bilateral negotiations with Asian states to avoid being left behind while countries such as the US and Japan gain improved market access.[15] The Swiss government too justifies its policy of pursuing free trade agreements by arguing that it needs to secure market access for Swiss firms on par with competitors from other countries that are also expanding their network of free trade agreements, such as the EU, US and Japan.[16]

In summary, and third, the wide spread emergence of regional markets is leading to a vicious circle between the WTO and the free trade areas. Once countries are embedded into regional markets and their trade is conducted 70, 80 or even 90 percent regionally (which holds true for many countries today), interest in a global trade order will wane. Put another way, the lack of negotiating success at the WTO leads to greater interest in regional free trade agreements which, in turn, weaken the WTO and make regional arrangements even more attractive. The creation of free trade agreements not only adds a new dimension to the world trade order, as outlined above, but also tends to lead to more such agreements being made. Thus, there is a danger that the original ambition for integrated and open world markets is being undermined by the numerical increase in regional free trade agreements.

G. Curse of Reciprocity

In 1846, after the British Parliament came to the conclusion that agricultural protectionism was no longer opportune, Prime Minister Sir *Robert Peele* rescinded the "Corn laws" one-sidedly and without considering the trade policy applied by continental European trading partners. Up to that point, in Great Britain foreign policy was based on reciprocity. This policy came in 1846 to an end, to be replaced by unilateralism.[17]

In the early decades of the twentieth century, reciprocity went through a period of renaissance. The US "Reciprocal Trade Agreement Act 1934" tied the granting of tariff reductions to equivalent concessions. According to *Cordell Hull*, the author of the 1934 Act, unilateral tariff reductions vis-à-vis foreign trading partners would not have been accepted by Congress in a time of unemployment. The tit-for-tat approach used by the US and later adopted by the GATT and the WTO, is based upon mercantilist principles whereby exporting is good and importing bad. The fact that free trade increases economic output and growth levels, irrespective of what foreign trading partners do, was not up for

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13 Baldwin (1993), p. 91. The US about-turn is also described in the Baker & McKenzie's handbook on NAFTA. Baker & McKenzie (1994), p. 9.

14 Crawford/Laird (2001), p. 201, cited in Sen (2006), p. 584.

15 BDI (2007).

16 Seco, *Free Trade Agreements* (Internet, last viewed September 2007).

17 See e.g., Bhagwati (2002), p. 3; Irwin (2002), p. 61 sqq.

discussion, neither in relation to US trade policy in the 1930s, nor as part of the GATT and WTO regimes.[18] The reciprocity rules of the GATT and of the WTO correspond more to "undisciplined liberalism" than "disciplined mercantilism".[19]

In respect of future negotiations, one must assume that the principle of reciprocity will tend to lead to higher rather than lower tariff levels. Reciprocity will deter trading partners from liberalising their markets unilaterally. They will use reciprocity to gain a better bargaining position in negotiations. In other words, there is a suggestion that countries are not reducing tariffs so as to maintain leverage for future negotiations. Past experience has even shown that some countries, such as the US and Switzerland, have raised tariff levels with a view to gaining more room to negotiate.[20]

Therefore, and fourthly, it can be held that the mercantilist style of negotiations evidenced at the GATT and the WTO, based on the principle of reciprocity, rests like a curse on the world trade order and impedes future trade negotiations. In this regard, it must be noted that, in recent years, individual WTO members (i.e. Australia and New Zealand) have contributed to the liberalisation of world trade by reducing their tariffs irrespective of whether or not other members made reciprocal concessions.[21]

H. Domestic Dimension of Foreign Trade Policy

Governments, parliaments and political parties avail themselves of foreign trade and many other policy areas (such as agriculture, finance, social and environmental policy) as an instrument to maintain and expand their power base. Peter-Tobias Stoll and Frank Schorkopf have observed that one can not regard political institutions as independent bodies that strictly follow an abstract notion of rationality. Rather, such political institutions, as well as the individuals and groups that support them, are deeply rooted in society and depend on community support, not only in elections. Thus, the interests of individuals and groups related to political institutions are reflected in the decision making process.[22]

In order to remain in power, or attain it, political parties will go to extremes to follow the wishes and demands of individual groups of voters, even if these represent only minorities. This explains, for instance, why it is that agricultural interests in industrialised countries, although they only account for 2 to 4 percent of the population, have been able to protect their interests vis-à-vis foreign countries for many decades. The same can be said about cotton farmers in the US. The assertion that international agreements (e.g. in the WTO context) are used by states to restrain domestic pressure groups does not entail that politicians place free trade above their own voters. Rather, politicians use the

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18 On reciprocity throughout history see Senti (2005), p. 316 sqq.

19 When Rolf J. Langhammer speaks of "disciplined mercantilism" he is focusing on the expected equivalence of the respective concessions. Langhammer (2002), p. 315.

20 See Senti (2005), p. 334 sqq.

21 Compare Bhagwati (2002).

22 Stoll/Schorkopf (2002), mn. 101.

subject of foreign trade to advance their own party's interests at the expense of political opponents.[23] Foreign trade policy is actually a manifestation of domestic politics.

Thus, the fifth conclusion is that the political consideration given to interest groups domestically will continue to have a significant impact on the world trade order. The fact that domestic politics plays a role in foreign trade policy is well known. It is possible that related questions have become more prominent with the deepening of public choice considerations.

I. Relevance of Non-governmental Organisations (NGOs)

It is very likely that non-governmental organisations (NGOs) will play an increasingly important role in international trade. On the one hand, they form institutions which assume functions which the WTO does not fulfil and, on the other hand, they act as critics of the prevailing world trade order.

In the past few decades, NGOs that deal with social standards and provisos have emerged with a view to exerting influence over the world trading order. Examples of such organisations include Fairtrade Labelling Organization International (FLO), Rugmark and the Business Social Compliance Initiative (BSCI). The FLO seeks to raise the social standards of producing firms and improve the quality of products they procure by way of certification. As a consortium of producers and retailers of carpets, as well as their trade representatives, Rugmark is pursuing the prohibition of child labour under the age of 14. BSCI of Brussels aims to improve social standards in developing and emerging nations, to harmonise company audits and to serve as a junction between the various national members.[24]

For many years, the GATT went about its task of designing the world trade order unchallenged. As part of the ever louder discussions on developing countries and environmental protection, many NGOs voiced concerns that the world trade order was not addressing social and environmental issues adequately. The first demonstrations against the WTO took place in Geneva in 1998. This was followed by the "Battle of Seattle". Opponents of the WTO successfully managed to unite a wide ranging collection of NGOs and economically weak nations in painting the WTO as a common enemy. NGOs were criticising that the WTO had grown into a powerful international organisation governed by unelected civil servants, that the WTO was eliminating national law and that the WTO had aligned itself against the interests of developing countries and environmental protection. However, such allegations were aimed at the wrong target, as the WTO itself does not have any decision making power. It is the WTO's members who make decisions. Also, in the words of Hermann Sautter, NGOs are "completely blind to reality" when they regard the failure of Ministerial Conferences as triumphs for developing countries. With the weakening of the WTO and the prevalence of bilateral trade agreements, developing countries are certainly worse off than under the WTO regime.[25]

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[23] The thesis that international law has a disciplining effect on national law is often recited by representatives of international organisations. See Roessler (1992), p. 5 sqq.; see also the reference to Tumlir in: Meessen (2005), p. 25, note 41.

[24] See Senti (2006), p. 32 sqq.

[25] See Sautter (2004), p. 124.

Therefore, and sixth, it must be assumed that NGOs will play a significant and valuable role in international trade policy in the future. Meanwhile, their criticism of the WTO will tend to harm developing countries rather than benefit them.

J. Final Conclusions

What repercussions are the current developments in the area of international economic law having on the competitive order between states? Are the changes that are becoming evident in the WTO context having a strengthening or a weakening effect on the international competitive order?

First, it is very doubtful that worldwide tariff reductions will continue in the coming years. On the one hand, national politicians are defending foreign trade barriers in the interest of their own voters. On the other hand, a common external customs tariff represents a potent sign of togetherness amongst countries engaged in regional trade agreements, one that is too strong to be given up. The demands of developing countries for a reduction in the high levels of agricultural tariffs in industrialized countries and the counter demands by developed nations for reductions in industrial tariffs in developing countries has led to a stalemate. This stalemate is not conducive to an improvement in the competitive order between states.

It is very likely that non-tariff barriers, both in goods and services trade, will rise in the coming years. The increase in regional trade arrangements means that the bureaucratisation of world trade will also increase due to the fact that countries require specific certificates of origin and valuation and, in addition, because region specific customs tariffs are emerging. The assertion that regional free trade is better than no free trade belongs in the realm of fairy tales. Increases in non-tariff barriers in the context of regional free trade agreements is impeding competition between WTO members.

The principles of Most Favoured Nation and National Treatment, embedded in today's world trade order, will become increasingly exceptional. These principles are undermined by over 200 free trade, preferential trade and economic partnership agreements which do not confer to third countries the privileges accorded to those who are part of these agreements. The exceptional rules on regional integration evidenced in Article XXIV of the GATT and Article V of the GATS contradict the notion of free trade throughout the world.

The "positive efforts" which should be undertaken in respect of developing countries according to the WTO's preamble are similarly at risk in the long run, not least due to the entrenched principle of reciprocity. Developing countries insist on maintaining high industrial tariffs, while industrialised nations protect their agricultural sectors. And no country is willing to forego such protectionism without reciprocation, on top of which, economically weaker countries are often not in a position to make reciprocal offers in the first place.

From an institutional point of view, the emergence of numerous free trade and economic partnership agreements has led to an identity crisis at the WTO. In future, the WTO will no longer represent an organisation made up of independent states and autonomous customs territories, but rather it will consist of members of free trade and economic partnerships agreements. A consequence of this is that representatives of independent states and autonomous customs territories will not advance the views of regions and

representatives of free trade and economic partnerships agreements will not advance the interests of independent states and autonomous customs territories. Such asymmetrical representation weakens cross-border competition.

Notwithstanding the many negative prospects for the WTO, the dispute settlement body seems to represent a positive aspect. The dispute settlement body is an institution which facilitates the resolution of local trade conflicts before they can grow to a world-wide conflagration. It also assists governments in settling trade disputes without losing their face. The fact that WTO dispute settlement reports evidence a 70 to 80 percent compliance level is impressive.

The prospects for international trade policy are dim. In order to brighten the outlook, there needs to be a "reorganisation round", rather than just another negotiation round. This round should address the reciprocal mode of negotiations, the redrafting of economic integration clauses (Article XXIV GATT), the reintegration of regional markets, adherence to the MFN and National Treatment principles, the rearrangement of trade in agriculture and of services trade and this round should also discuss the realignment of antidumping and countervailing duty rules. In the absence of such reorientation, in line with the changes which world trade has undergone over the past years, the WTO runs the risk of degenerating into an organisation, analogously to other international organisations, that is only engaged with itself and which does not contribute to competition between states.

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The Impact of *Amicus Curiae* Briefs in the Settlement of Trade and Investment Disputes

Federico Ortino[*]

The aim of this paper is to explore the interactions between international economic law and civil society. The starting point is to analyse the role of international economic law in facilitating the "competition of systems" (principally by reducing barriers to international trade and investment) and to highlight the implications of international economic law for civil society (mostly focusing on the non-economic values affected by international economic law). Focusing on the *Shrimp/Turtle* and *Methanex* disputes (concerning environmental protection and public health) brought under the World Trade Organization (WTO) and the North-America Free Trade Agreement (NAFTA), respectively, the study examines the role and impact that civil society has on the application of international economic law and in balancing economic and non-economic values.

A. International economic law in the competition of systems and the implications for civil society

While the underlying long-term objectives of international economic cooperation include broad political and socio-economic objectives,[1] the immediate goals of international economic law are to encourage and promote trade and investment flows across national borders. In operational terms, these goals materialize in the reduction or elimination of "barriers" to trade and investment flows. In principle, any governmental measure with an adverse impact on trade and investment flows may be perceived as a potential barrier. "Barriers" include "market access" measures (such as custom duties, import and export quotas, pre-entry restrictions) and "market regulation" measures (such as internal taxes, technical regulations, performance requirements). There exist several (even concurring) ways of tackling trade and investment barriers, which depend on each specific governmental measure at issue and its adverse impact on trade and investment flows. For example, governments may agree to 1) eliminate or reduce progressively custom duties and/or import quotas; 2) eliminate "market access" measures and prohibit "discriminatory" domestic ones; 3) prohibit "unreasonable" or "unfair" market access measures and/or market regulation measures; 4) adopt the principle of mutual recognition; 5)

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[1] These include preserving peace and stability among nations, ensuring full employment, promoting sustainable development, protecting the environment, enforcing basic workers' rights. See for example, the preambles to the WTO Agreement and the North America Free Trade Agreement (NAFTA).

harmonise "market regulation" measures or 6) replace all restrictive national regulations with uniform rules.

The approach followed by the great majority of economic agreements between States is one focusing on "negative" integration, i.e., eliminating market access measures and prohibiting discriminatory or unreasonable market regulation measures. For example, the General Agreement on Tariff and Trade (GATT), one of the cornerstones of the world trading system under the World Trade Organization (WTO), as an example, prohibits import and export quotas (Article XI), prohibits discriminatory internal taxes and regulations (Article III) and envisages the progressive reduction of custom duties (Article XXVIII bis). Chapter 11 of the North-America Free Trade Agreement (NAFTA) dealing with investment prohibits *inter alia* discriminatory market access and market regulation measures (Article 1102), expropriation without compensation (Article 1110) and excessively unfair market regulation measures (Article 1105).

On the other hand, "positive" integration (or harmonization) strategies are quite rare in international law. In the WTO for example, there are only very few instruments that may be referred to as forms of positive integration. First, both the SPS and TBT Agreements require Members to base their sanitary and technical measures on "international standards", where available (Article 3 SPS and 2.4 TBT).[2] Second, the GATS provides for a normative mandate to the Council for Trade in Services to develop any necessary disciplines in order to ensure that measures relating to certain "domestic regulation" (ie., qualification requirements and procedures, technical standards and licensing requirements) do not constitute unnecessary barriers to trade in services (Article VI:4 GATS).[3]

The reduction or elimination of trade and investment barriers by negative integration strategies has the dual effect of facilitating and stimulating the "competition of systems", understood here as competition between different systems of rules and institutions. Negative integration strategies facilitate system competition because they have the effect of enlarging geographic markets and reducing transaction costs.[4] Equally, negative integration strategies stimulate system competition because they tend to maintain national regulatory prerogatives and as such differences in the ways countries regulate the economy.

Given the potentially broad understanding of "barriers" to trade and investment (including internal regulatory matters such as labour laws, health regulation, environmental standards) and the fundamentally "negative" nature of economic integration strategies, international economic law has the potential to restrain States' ability to regulate for the pursuit of non-economic policies (including employment, health, consumer, environmental policies). In normative terms, how far should international economic law go in facilitating trade and investment flows and restraining States' ability to regulate? Depending on the answer, the impact of international economic law may change in both quantitative and qualitative terms. For example, emphasis on economic liberalisation

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2 On the SPS Agreement see Joanne Scott, *The* WTO *Agreement on Sanitary and Phytosanitary Measures: A Commentary* (OUP, 2007) ch 7.

3 This provision has so far only been applied once with regard to the accountancy sector. See *Disciplines on Domestic Regulation in the Accountancy Sector*, S/L/64, adopted by the Council for Trade in Services on 14 December 1998.

4 K. Meessen, *Economic Law in Globalizing Markets*, at 46.

policies may produce greater overall wealth gains, while emphasis on non-economic regulation may produce better individual living standards.

The realization of the relevance of international economic rules and institutions in establishing the balance between economic liberalization objectives and national regulatory prerogatives has catapulted such laws and institutions at the centre of the political debate particularly at the grass-root level. Environmental activists, labour unions, trade associations, academics have been keen to participate in, and influence, the law- and decision-making processes at the international level. One particular focus of civil society's attention has been the dispute settlement processes provided by most international economic agreements. Given the broad and undefined nature of many of the principles adopted by international trade and investment agreements, dispute settlement institutions play a significant role in the interpretation and definition of such principles. Accordingly, the aim of the following sections is to analyse the extent of the participation and impact of civil society on trade and investment dispute settlement processes.

B. The impact of civil society on WTO dispute settlement: Shrimp/Turtle

I. Background of the case

The dispute at issue in *United States – Import Prohibition of Certain Shrimp and Shrimp Products* (*Shrimp/Turtle*)[5] arose against a backdrop of concerns in the United States about the incidental capture and drowning of sea turtles by shrimp trawlers, which scientific evidence shows constitutes the most significant risk to endangered species of sea turtles. In 1987, pursuant the 1973 Endangered Species Act ("ESA"), the United States issued regulations requiring all shrimp trawlers to use turtle excluder devices ("TEDs") or tow time restrictions in specified areas that had significant mortality of sea turtles. In 1989, the United States enacted Section 609 of US Public Law 101-162 ("Section 609") which required *inter alia* the following: (a) the US Secretary of State, in consultation with the US Secretary of Commerce, shall initiate negotiations for the development of bilateral or multilateral agreements aimed at the protection and conservation of sea turtles further legislation; (b) as of May 1, 1997, the importation of shrimp or shrimp products that have been harvested with commercial fishing technology likely to hurt sea turtles shall be prohibited. Such prohibition would not apply if the President annually certifies to the Congress that (i) the harvesting country concerned has a regulatory programme governing the incidental taking of such sea turtles that is comparable to that of the United States, (ii) the average rate of that incidental taking by the vessels of the harvesting country is comparable to the average rate of incidental taking of sea turtles by Unites States vessels in the course of such harvesting, or (iii) the fishing environment of the harvesting country does not pose a threat to sea turtles in the course of such harvesting.[6]

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5 *United States – Import Prohibition of Certain Shrimp and Shrimp Products* (*Shrimp/Turtle*), WT/DS58, brought 14 October 1996.

6 Appellate Body Report on *Shrimp/Turtle*, WT/DS58/AB/R, circulated 12 October 1998, adopted 6 November 1998, paras. 2-6.

In 1993, the United States issued guidelines for comparing foreign regulatory programs with the US program. These guidelines limited the scope of application of Section 609 to the wider Caribbean/western Atlantic region and required, *inter alia*, a commitment that all shrimp trawlers use TEDs at all times. In 1996, following a ruling by the US Court of International Trade, the Department of States extended the reach of Section 609 to all countries and permitted the importation into the United States of shrimp or shrimp products harvested with commercial fishing technology (i.e., shrimp not harvested by manual methods with no harm to sea turtles) *only* in the event that it originated in a country which had been certified by the President according to Section 609.[7]

In 1997, at the requests of Malaysia, Thailand, Pakistan, and India, the Dispute Settlement Body of the WTO established three panels, which were later merged into one, in order to examine the GATT compatibility of the US ban on importation of certain shrimp and shrimp products under Section 609 and the "Revised Notice of Guidelines for Determining Comparability of Foreign Programs for the Protection of Turtles in Shrimp Trawl Fishing Operations".[8]

II. Admissibility of *amicus curiae* briefs

In the course of the proceedings, the Panel received two *amicus curiae* briefs submitted respectively by the World Wide Fund for Nature (WWF) and jointly by the Center for Marine Conservation (CMC) and the Center for International Environmental Law (CIEL). The *amici* requested the Panel to issue a formal ruling that Article 13 of the DSU empowers WTO panels to receive and, where appropriate, to consider *amicus* briefs offered by groups with relevant expertise. While the respondent (the United States) urged the Panel to avail itself of any relevant information in the two documents, as well as in any other similar communications, the complaining parties (India, Malaysia, Pakistan and Thailand) requested the Panel not to consider the content of these documents. In one of its preliminary rulings, the Panel informed the disputing parties that it did not intend to take the two *amicus* briefs into consideration as accepting non-requested information from non-governmental sources would be incompatible with the DSU. However, following the Panel statement that any party to the dispute was free to put forward these documents as part of their own submissions, the United States included Section III ("Statements of Facts") of the document submitted by the CMC and CIEL as an annex to its second submissions.[9]

The United States appealed the decision to the Appellate Body claiming that the language of Article 13.2 of the DSU is broadly drafted to provide a panel with discretion in choosing its sources of information, including unsolicited *amicus curiae* brief.[10] In

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[7] Appellate Body Report on *Shrimp/Turtle*, *supra* n. 6, para. 5.

[8] Cf D. Ahn, *Environmental Disputes in the GATT/WTO: Before and After US-Shrimp Case*, 20 Mich. J. Int'l L. (Summer, 1999) 819; S Gaines, *The WTO's Reading of the GATT Article XX Chapeau: A Disguised Restriction on Environmental Measures*, 22 U. Pa. J. Int'l Econ. L. (Winter, 2001) 739; P. Mavroidis, *Trade and Environment after the Shrimps-Turtles Litigation*, 34 JWT (2000) 73.

[9] Panel Report on *Shrimp/Turtles*, WT/DS58/R, circulated 15 May 1998, at paras. 7.7-7.8.

[10] The United States nevertheless attached to its appellant's submissions three *amicus curiae* briefs.

their *amicus curiae* brief, the CMC and CIEL (hereinafter CIEL/CMC brief)[11] argued that acceptance of *amicus* briefs is supported by both Article 11 ("Function of panels")[12] and Article 13 ("Right to seek information") of the DSU and by the reference to sustainable development in the Preamble to the WTO Agreement.[13] Interestingly, while the appellees stood by the Panel's finding, some (but not all) of the third participants sided with the US argument at least to the extent that a panel has the authority (or the discretion) to consider unsolicited *amici* briefs.[14] During the hearing on the case, Appellate Body members asked the US government questions about the substance of the various NGO briefs, thus signaling that they had been read.[15]

In its decision, the Appellate Body concluded that the Panel erred in its legal interpretation that accepting non-requested information from non-governmental sources is incompatible with the provisions of the DSU. The Appellate Body noted that a panel is obliged in law to accept and give due consideration only to submissions made by the parties and the third parties in a panel proceeding. However it justified its finding of admissibility of *amicus curiae* briefs emphasizing that the DSU accords to a panel ample and extensive authority to undertake and to control the process by which it informs itself both of the relevant facts of the dispute and of the legal norms and principles applicable to such facts. According to the Appellate Body, such authority, and the breadth thereof, is indispensably necessary to enable a panel to discharge its duty imposed by Article 11 of the DSU.

III. Interpretation of the general exception under Article XX GATT

Following the US government's *de facto* admission that its import ban on shrimp was a restriction in the sense of Article XI,[16] the merit of the dispute revolved around the issue of whether the US environmental measure was justified on the basis of Article XX GATT. Article XX allows WTO Members to adopt measures inter alia "relating to the conservation of exhaustible natural resources" (subparagraph (g)) subject to the proviso that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination, or a disguised restriction on international trade (introductory clause or chapeau).

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[11] Three additional NGOs authored the CIEL/CMC brief submitted to the Appellate Body: (1) Red Nacional de Accion Ecologica (RENACE), a national network of 140 Chilean citizen organizations working to protect environment and quality of life, (2) The Environmental Foundation Ltd., a Sri Lankan public interest environmental law firm, and (3) the Philippine Ecological Network (PEN), a network of individuals and organizations protecting the environment in the Philippines through advocacy and information exchange.

[12] Article 11 DSU provides that a panel must undertake "an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements."

[13] CIEL/CMC brief, at 45. The WWF brief did not examine this issue.

[14] See Australia and European Communities, at paras. 53 and 65-66.

[15] See Steve Charnovitz, *Opening the WTO to Non-Governmental Interests*, 24 Fordham Int'l L.J. 173 (2000) at 6 available at www.worldtradelaw.net.

[16] Panel Report on *Shrimp/Turtle*, *supra* n. 9, para. 7.17.

The Panel rejected the US claim with regard to the availability of the general exception provision of Article XX, since the US measure at issue constituted "unjustifiable discrimination" within the meaning of the introductory clause of Article XX. The Panel held that an interpretation of Article XX chapeau that allowed a Member to take measures conditioning access to its market for a given product upon the adoption by the exporting Members of certain policies (such as that at issue in that case) would have undermined the security and predictability of the WTO multilateral trading system as a whole.[17]

Following a United States appeal, the Appellate Body reversed the Panel's findings with respect to Article XX, noting that the interpretative analysis embodied in the Panel's report constituted error in legal interpretation.[18] In particular, the Appellate Body noted that constructing an *a priori* test that purports to define a category of measures which *ratione materiae* fall outside the justifying protection of Article XX's chapeau (i.e., measure conditioning access to a Member's domestic market upon the adoption by the exporting Members of certain policies) would render most, if not all, of the specific exceptions of Article XX inutile. It is usually those types of measure that fall within the scope of the general exception provision of Article XX.[19] The Appellate Body thus went on to complete the legal analysis in order to determine whether Section 609 indeed qualified for justification under Article XX.

For purposes of our analysis, we only focuses on two issues addressed by Appellate Body in interpreting and applying Article XX: (1) the meaning of "exhaustible natural resources" for purposes of subparagraph (g) and (2) the meaning of "unjustifiable discrimination" for purposes of the chapeau.

1. The meaning of "exhaustible natural resources" for purposes of Article XX(g)

The United States argued that sea turtles fell under the definition of "exhaustible natural resources" for purposes of Article XX(g) as they were an endangered species (ie., they were nearly exhausted). The complainants (and joint appellees) contended that the term "exhaustible natural resources" did not include sea turtles. First, the term "exhaustible" seems to refer to "finite resources such as minerals, rather than biological or renewable resources"; second, if all natural resources were considered to be exhaustible, the term "exhaustible" would become superfluous; furthermore, the drafting history of Article

[17] Panel Report on *Shrimp/Turtle*, *supra* n. 9, paras. 7.44-45. It is interesting to note that some of the reasoning put forward by the Panel in its refusal to interpret the chapeau as allowing the US import ban resembles the "regulatory overlap" arguments underlying the *Dassonville-Cassis de Dijon* jurisprudence in European Community law. Note the Panel's following statements: "if one WTO Member were allowed to adopt such measures [conditioning access to its market for a given product upon the adoption by the exporting Members of certain policies, including conservation policies], then other Members would also have the right to adopt similar measures on the same subject but with differing, or even conflicting, requirements. […] Market access for goods could become subject to an increasing number of conflicting policy requirements for the same product and this would rapidly lead to the end of the WTO multilateral trading system." *Ibid.*, para. 7.45.

[18] *Ibid.*, paras. 115-121.

[19] *Ibid.*, para. 121.

XX(g) supported their interpretation; finally, sea turtles, being living creatures, could only be considered under Article XX(b) (covering measures for the protection of "animal life and health"), since Article XX(g) was meant for "nonliving exhaustible natural resources".[20] While same third participants agreed with the reading suggested by the United States (Australia and the European Communities), other supported the position of the complainants (Hong Kong, the Philippines, Singapore).[21] Although it provided evidence of the endangered species status of sea turtles, the CIEL/CMC brief took for granted that the term "exhaustible natural resources" applied to sea turtles.[22]

The Appellate Body rejected the strict reading advanced by the complainants with regard to the meaning of the term "exhaustible natural resource". Taking into account "contemporary concerns of the community of nations", the Appellate Body endorsed an "evolutionary" interpretation of the term "exhaustible", which embraces both living and non-living resources.[23] Invoking modern biological science and the international recognition of the sea turtles' endangered status, the Appellate Body concluded that sea turtles were indeed "exhaustible natural resources" for purposes of Article XX(g).

2. The meaning of "unjustifiable discrimination" for purposes of the chapeau to Article XX

In its appeal the United States argued that if a measure differentiates between countries on a basis "legitimately connected" with one of the policy justifications of Article XX, rather than for protectionist reasons, that measure does not amount to an abuse of the applicable Article XX exception. Joint appellees supported the decision of the Panel protecting the multilateral trade system from unilateral trade measures. In their view, if every WTO Member were free to pursue its own trade policy solutions to what it perceives to be environmental concerns, the multilateral trade system would cease to exist.[24] All third participants (including Australia and the European Communities) emphasized, in one way or another, the failure of the United States to explore the scope for working cooperatively with other countries to identify internationally shared concerns about sea turtle conservation issues and consider ways to address these concerns.[25] Even the CIEL/CMC brief emphasized that "international law of sustainable development prefers multilateral agreements", although unilateral measures are allowed under certain circumstances.[26] In the view of these NGOs,

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20 Panel Report, *Shrimp/Turtles*, at paras. 3.237-3.240.

21 Panel Report, *Shrimp/Turtles*, at paras. 4.1-4.73

22 CIEL/CMC brief, at 31.

23 *Ibid.*, para. 130.

24 Appellate Body Report, *Shrimp/Turtles*, at para. 35.

25 Appellate Body Report, *Shrimp/Turtles*, at para. 54. The EC noted that the appropriate way for Members concerned with the preservation of globally shared environmental resources to ensure such preservation is through internationally agreed solutions. Measures taken pursuant to such multilateral agreements would in general be allowed under the chapeau of Article XX. Id. at para. 72.

26 CIEL/CMC brief, at 29.

> [i]f the Appellate Body finds that the United States failed to exhaust multilateral efforts and thereby violated Article XX then any remedy should be narrowly tailored to correct this specific deficiency. The WTO should also make it clear that they will not condone future refusals by Complainants to negotiate a multilateral agreement to protect sea turtles.[27]

The Appellate Body agreed with the positions of the appellees, third participants and NGOs. Having emphasised that the purpose and object of the introductory clause of Article XX is generally the prevention of abuse of the exceptions of Article XX and that such clause embodies the recognition on the part of WTO Members of the need to maintain a balance between the *right* of a Member to invoke an exception under Article XX and the *duty* of that same Member to respect the treaty rights of the other Members,[28] the Appellate Body found that the US measure had in fact been applied in an unjustifiable discriminatory manner. Among the bases for such finding, the Appellate Body relied on the failure of the United States to engage the appellees (as well as other Members exporting shrimp to the United States) in serious, across-the-board negotiations with the objective of concluding bilateral or multilateral agreements for the protection and conservation of sea turtles, before enforcing the import prohibition against the shrimp exports of those other Members.

In this regard, the Appellate Body noted the following points: (1) the US Congress expressly recognised the importance of securing international agreements for the protection and conservation of the sea turtles species in enacting Section 609; (2) as recognised by the WTO itself as well as in significant number of other international instruments and declarations, the protection and conservation of highly migratory species of sea turtles, that is, the very policy objective of the measure, demands concerted and cooperative efforts on the part of the many countries whose waters are traversed in the course of recurrent sea turtles migrations; and (3) the fact that the United States did negotiate and conclude one regional international agreement for the protection and conservation of sea turtles provides convincing demonstration that an alternative course of action was reasonably open to the United States for securing the legitimate policy goal of its measure, a course of action other than the unilateral and non-consensual procedures of the import prohibition under Section 609.[29]

In the subsequent dispute over the implementation by the United States of the DSB recommendations with regard to the US regime for the importation of shrimp and shrimp products,[30] the Appellate Body clarified that the duty to pursue international cooperation under Article XX only requires a "serious good-faith effort to negotiate an international agreement".[31]

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27 CIEL/CMC brief, at 30.

28 *Ibid.*, para. 156.

29 *Ibid.*, paras. 166-71.

30 *United States – Import Prohibition of Certain Shrimp and Shrimp Products, Recourse to Article 21.5 of the DSU* (*Shrimp – Article 21.5*), WT/DS58, brought 23 October 2000.

31 Appellate Body Report, *Shrimp – Article 21.5*, at paras. 129-34.

IV. Some tentative remarks

The initial, very brief, observation is that, despite recognizing a panel's powers to consider unsolicited *amicus curiae* briefs, the Appellate Body in *Shrimp/Turtle* does not refer once to the factual and legal arguments advanced by the NGOs.[32]

Second, despite the lack of any express reference to the NGOs briefs, the positions advanced by the NGOs were "substantially" adopted by the Appellate Body: this is certainly true with regard to the admissibility in principle of *amicus curiae* briefs in WTO dispute settlement and the broad interpretation of the term "exhaustible natural resources" to include living resources such as sea turtles. It is equally true with regard to the interpretation of the notion of "unjustifiable discrimination" as the NGOs had emphasized the importance and preference for a "multilateral" solution to environmental problems (which the Appellate Body found the United States had not attempted). However, the same can be said for the positions advanced by Australia and the European Communities as third participants to the dispute. Equally, it is difficult to determine the actual impact of the NGOs' factual and legal arguments on the outcome of the case when it appears that all those arguments had also been advanced and extensively argued by the complainants, the respondent and/or the third participants.

Furthermore, one distinct contribution made by the NGOs appears to be their emphasis on (the relevance of) international principles of sustainable development and international environmental law, which permeates the CIEL/CMC brief. For example, according to the NGOs, international principles of sustainable development support the requirement of the use of TEDs and recognize the preference for multilateral agreements, although unilateral measures are allowed. Equally, international environmental law requires the protection of endangered, migratory marine resources (such as sea turtles) and imposes duties to prevent environmental harms beyond territorial boundaries. It may not be too difficult to accept the argument that such contribution did have an impact on the "environmentally-friendly" interpretations adopted by the Appellate Body in *Shrimp/Turtle*.

Finally, and more fundamentally perhaps, the participation of the NGOs in the legal proceedings in *Shrimp/Turtle* (even if apparently only of a formal nature) symbolized in the minds of the Appellate Body the interest and involvement of global society in the workings of the WTO. The eyes of the many stakeholders interested in the outcome of the dispute but with no direct access to the decision-making process were on the Appellate Body. It is no surprise that the Appellate Body, first of all, reversed the Panel's rigid interpretation of its authority to consider unsolicited *amicus curiae* briefs and, secondly, interpreted the general exception provision in Article XX GATT in accordance with principles of environmental protection and sustainable development. In this sense, *Shrimp/Turtle* is a typical example of the Appellate Body's early efforts to strengthen its (and consequently the WTO's) external legitimacy.[33]

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[32] This applies to the Panel report, albeit in that case the United States had incorporated part of the CIEL/CMC brief in its submissions.

[33] Thomas Cottier, *The WTO and Environmental Law: Three Points for Discussion*, in Agata Fijalkowski & James Cameron (eds.), *Trade and the Environment: Bridging the Gap* (T.M.C. Asser Instituut, 1998) at 59. See J. Weiler, *The Rule of Lawyers and the Ethos of Diplomats: Reflections on the Internal and External Legitimacy of WTO Dispute Settlement*, Jean Monnet Working Papers (9, 2000). Weiler also points out the argument that a system which only allows access to govern-

C. The impact of civil society on NAFTA dispute settlement: Methanex

I. Background of the case

The dispute in *Methanex Corp. v. United States of America* (*Methanex*) revolved around the regulation of methyl tertiary butyl ether (MTBE) in the production of gasoline. MTBE is a chemical compound produced from methanol and isobutylene. MTBE is used as a fuel additive as it is a source of octane (improving a fuel's resistance to uncontrolled combustion) and an oxygenate (increasing the oxygen content of gasoline). Following a scientific assessment carried out on MTBE, the State of California determined that the use of the chemical-based oxygenate presented a significant risk to the environment and public health, in particular, traces of MTBE had been found in underground water. Consequently, in 1999 California imposed a libelling requirement on methanol, and in 2000 it imposed a ban on the sale of gasoline produced with MTBE (which was supposed to enter into effect on 1 January 2003).

Methanex, a Canadian company, with subsidiaries in the US, is a major producer of methanol (one of the components of MTBE). In December 1999, Methanex initiated arbitration under NAFTA Chapter 11 (on investment) against the US claiming that the California ban violated Article 1102 on National Treatment, Article 1105 on Minimum Standard of Treatment and Article 1110 on Expropriation and demanded compensation in the amount of US$ 970 million (including interests and costs). Methanex argued that (1) methanol is a safe, effective and economic component of gasoline; (2) its use has been approved and encouraged by the US Federal Government after exhaustive study, as well as the European Community; (3) California's drinking water problem is principally caused by leaking underground storage gasoline tanks and the obvious and reasonable solution is not to ban MTBE, but to stop gasoline leakages; (4) the permitted competitive gasoline oxygenate, ethanol, generally manufactured from biomass feedstocks such as corn, is not energy efficient and may be harmful to the environment and to human health (in contrast to MTBE, ethanol is carcinogenic); (5) while the US is one the larger producers of ethanol, the US methanol industry is very small and in particular California has no methanol industry of its own.

II. Admissibility of *amicus curiae* briefs

In the course of the arbitration, a petition by the Institute of International Sustainable Development (IISD) and a joint petition by Communities for a Better Environment (CBE), the Bluewater Network of Earth Island Institute ("Earth Island Institute") and the Center for International Environmental Law (CIEL) were submitted to the Tribunal requesting permission inter alia to (a) file an *amicus curiae* brief, (b) receive materials generated within the arbitration and (c) have observer status at the oral hearing.[34]

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ments may be "skewed in all kind of directions, principally by unequal access of private actors (notably multinationals) to Governments". Id., at 13.

[34] IISD petition, 25 August 2000; CBE/Earth Island Institute/CIEL petition, 13 October 2000. All the documents relating to the *Methanex* dispute referred to in this section are, unless otherwise stated, available at www.naftaclaims.com/disputes_us_methanex.htm.

Permission was sought on the basis of the immense public importance of the case and the critical impact that the Tribunal's decision will have on environmental and other public welfare law–making in the NAFTA region. Equally, participation of *amici* would allay public disquiet as to the closed nature of arbitration proceedings under Chapter 11 of NAFTA. The IISD also contended that the interpretation of Chapter 11 of NAFTA should reflect legal principles underlying the concept of sustainable development, and that the IISD could assist the Tribunal in this respect. Furthermore, the petitioners argued that the Tribunal had the power to grant the petitions under its general procedural powers contained in Article 15 of the UNCITRAL Arbitration Rules.[35] There was in fact nothing in Chapter 11 to prevent the granting of the permission requested by the NGOs. Reference was also made to the practice of the WTO Appellate Body and courts in Canada and the United States.[36]

While the United States, as the respondent, and Canada (one of the three NAFTA parties) invited the Tribunal to accept the NGOs' petitions,[37] the claimant, Methanex Corp, and Mexico (the third NAFTA party), requested that the NGOs' petitions be dismissed.[38]

On the basis of Article 15(1) of the UNCITRAL Arbitration Rules, the Tribunal concluded that while it had in principle the power to (i) accept *amicus* submissions in writing from each of the petitioners, it had no power to accept petitioners' requests to (ii) receive materials generated within the arbitration and (iii) attend oral hearings of the arbitration.[39] The Tribunal set out the factors that should be considered in the exercise of the discretion under Article 15(1): (a) the extent to which petitioners' credentials and expertise may provide assistance to the Tribunal; (b) the extent of the public interest arising from the subject-matter of the specific arbitration; (c) the beneficial effect to the Chapter 11 arbitral process from being perceived as more open or transparent; (d) the risk of imposing extra burden on the disputing parties. Weighing all the relevant factors, the Tribunal reached the conclusion that "it could be appropriate to allow *amicus* written submissions from the petitioners."[40]

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35 Article 15(1) of UNCITRAL Arbitration Rules provides as follows: "Subject to these Rules, the arbitral tribunal may conduct the arbitration in such manner as it considers appropriate, provided that the parties are treated with equality and that at any stage in the proceedings each party is given a full opportunity of presenting its case."

36 Decision of the Tribunal on Petitions from Third Persons to Intervene as "Amici Curiae", 15 January 2001, at paras. 5-8

37 First and second submissions on amicus application, United States, 27 October 2000 and 22 November 2000; Submission in response to application for amicus standing, Canada, 10 November 2000.

38 Investor's first and second submissions on amicus application, 27 October 2000 and 22 November 2000; Submission in response to application for amicus standing, Mexico, 10 November 2000.

39 Decision of Tribunal on Petitions from Third Persons to Intervene as Amici Curiae, 15 January 2001, at para. 47.

40 Id., at para. 52.

III. The concept of "in like circumstances" for purposes of the National Treatment provision in Article 1102 NAFTA

The disputing parties advanced different methodologies for applying the national treatment provision in Article 1102, which requires NAFTA parties to accord to foreign investors or investments treatment no less favourable than that it accords, in like circumstances, to domestic investors or investment.

One of the major distinctions, which was the focus of the Tribunal's decision, dealt with the interpretation of the concept of "in like circumstances". Citing previous NAFTA and GATT jurisprudence, Methanex argued that the critical test for "likeness" is competition: two investors are "in like circumstances" if they are in a competitive relationship. Since methanol producers (including Methanex) are in competition with ethanol producers, they are in like circumstances for purposes of Article 1102. Accordingly, the different treatment (banning MTBE, which is made from methanol, and allowing ethanol) prima facie violated the national treatment obligation.[41]

The United States, on the contrary, argued that for purposes of determining whether two investors are "in like circumstances", the proper "comparator" is the domestic investor which is like (or if not like, then close to) the foreign investor in all relevant respects but for nationality of ownership. If no such domestic investor exists, a tribunal may look farther afield and expand the scope of domestic comparators as long as they are similar enough to justify considering their circumstances to be "like" that of the foreign investor. As there were a substantial number of domestic methanol producers, the United States argued that the proper comparator were those methanol producers. Since foreign and domestic methanol producers were treated equally, no violation of the national treatment obligation could be found. The United States, furthermore, rejected the relevance of the WTO jurisprudence interpreting the notion of "like products" in the context of the national treatment provision in GATT Article III.

Although it agreed with the United States regarding the irrelevance of the WTO jurisprudence, the IISD provided a somewhat different interpretation of the notion of "in like circumstances" for purposes of Article 1102 NAFTA. Although it noted that the competitive relation between investors is not an irrelevant element, the IISD argued that it is not the only element. Differential treatment for legitimate regulatory objectives (related for example to environmental protection) is a valid consideration for purposes of determining whether two investors are in like circumstances. As California chose a zero risk towards MTBE contamination, the IISD argued that the California's ban on MTBE was necessary to achieve that objective and as such methanol producers were not in like circumstances with ethanol producers.[42]

The arbitral tribunal in *Methanex* sided with the United States' reading of the concept of "in like circumstances". In the words of the *Methanex* Tribunal:

> It would be a forced application of Article 1102 if a tribunal were to ignore the identical comparator and to try to lever in an, at best, approximate (and arguably inap-

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41 Methanex conceded that a *prima facie* case of violation of the national treatment obligation (less favourable treatment of domestic and foreign investors in like circumstances) may be overturned if the respondent shows that the measure implements valid environmental goals.

42 IISD brief, 9 March 2004, at paras. 33-46.

> propriate) comparator. The fact stands – Methanex did not receive less favourable treatment than the identical domestic comparators, producing methanol.[43]

Although it also noted the WTO jurisprudence's irrelevance in interpreting the concept of "in like circumstances" in Article 1102,[44] the Tribunal concluded that even on the basis of the "trade" theory advanced by Methanex, the claim would fail because Methanex produced methanol as a feedstock for MTBE and not as a gasoline additive in its own right. As a result, in the Tribunal's view, the ethanol and methanol products could not be said to be in competition.[45] Interestingly, it is in connection with the Tribunal's discussion of the (ir)relevance of WTO jurisprudence that one can find the only substantive reference to the IISD's brief.[46]

IV. Interpretation of the Expropriation provision in Article 1110 NAFTA

Methanex also claimed that the California's measure violated Article 1110, which prohibits NAFTA parties from directly or indirectly expropriating foreign investments or taking measures tantamount to expropriation, except (a) for a public purpose (b) on a non-discriminatory basis (c) in accordance with due process of law and (d) on payment of compensation.

Methanex claimed that a substantial portion of its investments (including its share of the California oxygenate market) were taken and handed over to the domestic ethanol industry. In Methanex's view, such a taking was "at a minimum "tantamount […] to expropriation" under the plain language of Article 1110". Furthermore, Methanex summarily claimed that the California's measure was not intended to serve a public purpose, was discriminatory in nature, failed to comply with due process of law, and did not comply with the obligation to pay compensation.[47]

The United States' defense focused on two principal arguments. First, the California's measure alleged negative impact on Methanex's profitability is insufficient to support a finding of expropriation, particularly because Methanex failed to establish any reasonable expectation that MTBE would not be further regulated in California. Second, absent extraordinary circumstances (not present in the case at hand), *bona fide*, non-discriminatory regulatory actions taken to protect public health may not be deemed expropriatory.[48]

In its amicus brief, having noted the controversial notion of "regulatory expropriation", the IISD emphasized the existence of a split in the NAFTA cases on the topic, which mirrored the difference in formulation of the two disputing parties' arguments on

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43 Methanex, Award 9 August 2005, Part IV, Chapter B, at 9, para. 19.

44 Methanex, Award 9 August 2005, Part IV, Chapter B, at 14-19, paras. 29-37.

45 Methanex, Award 9 August 2005, Part IV, Chapter B, at 13, para. 28.

46 "The International Institute for Sustainable Development (IISD), in its carefully reasoned Amicus submission, also disagrees with Methanex's contention that "trade law approaches can simply be transferred to investment law". Methanex, Award 9 August 2005, Part IV, Chapter B, at 13, para. 27. For a critical comment see Todd Weiler, *Methanex Corp. v. U.S.A. – Turning the Page on NAFTA Chapter Eleven?*, 6 JWIT 903 (2005).

47 Methanex Second Amended Statement of Claims, 5 November 2002, at paras. 317-320.

48 Amended Statement of Defense of Respondent United States of America, 5 December 2003, at 396-417.

expropriation. The existence of an expropriation, which is subject to the treaty discipline may depend on the (adverse) *effect* of the measure vis-à-vis the foreign investment, on the one hand, or on the (bad faith) *purpose* of the measure, on the other hand. In the IISD's view, the latter approach was the correct approach and argued that the California's measure did not constitute an expropriation for purposes of Article 1110 NAFTA as it was a *bona fide* public health and welfare measures.[49]

The Tribunal rejected Methanex's claim under Article 1110 as the claimant had not established that the California's measure was "tantamount to expropriation". The crux of the Tribunal's understanding of the concept of (indirect or regulatory) expropriation may be found in the following sentence:

> […] a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.[50]

While this statement seems to reject an understanding of regulatory expropriation exclusively based on the measure's effects (as argued by the claimant), it is not clear whether it fully endorses the view put forward by the United States and the IISD regarding the *bona fide* purpose of the measure under review. On the contrary, the Tribunal seems to employ the three "conduct requirements" for lawful expropriation (non-discrimination, public purpose, and due process)[51] as the relevant criteria to determine whether a regulatory action constitutes a regulatory expropriation. One can argue that this is an even higher threshold in order for the claimant to establish expropriation compared with that advanced by the United States and the IISD. The tribunal, however, seems to accept the United States' view regarding the relevance of the investor's legitimate expectations (based on specific commitments given by the host government) for purposes of determining the existence of an expropriation.

V. Some tentative remarks

With only one explicit (complimentary) reference by the Tribunal to the IISD brief ("carefully reasoned" brief), it is difficult to establish with clarity the direct impact of the NGO's participation in the *Methanex* dispute settlement proceedings. It is undeniable that the Tribunal, at least in terms of results, sided with the IISD positions on the three central legal issues analyzed above: acceptability of *amicus curiae* brief, domestic ethanol producers were not in like circumstances with Methanex, the California's measure did not constitute regulatory expropriation. However, it is true that these were also the positions defended by the United States as the respondent in the case.

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49 IISD brief, 9 March 2004, at para. 79-96.

50 Methanex, Award, 9 August 2005, Part IV, Chapter D, at 4, para. 7.

51 See Audley Sheppard, "The Distinction Between Lawful and Unlawful Expropriation" in Clarisse Ribeiro (ed.) *Investment Arbitration and the Energy Charter Treaty* (Juris Publishing, 2006) distinguishing between 'conduct requirements' and 'compensation requirement'.

Moreover, looking at the actual reasoning underlying the Tribunal's finding with regard to each legal issue analyzed above, the picture gets even more complicated. With regard to the issue of the acceptability of *amicus curiae* brief, there appears to be a substantial overlap between the arguments advanced in the IISD brief and the Tribunal's legal reasoning. Particular mention deserve the views (shared by both the IISD and the Tribunal) regarding (a) the public interest nature of the subject-matter at issue in *Methanex* and (b) the beneficial effect (in terms of broader acceptance and confidence) to the Chapter 11 dispute settlement process from being perceived as more open and transparent.

On the other hand, with regard to the issues of the correct interpretation of the national treatment and expropriation provisions, there are certain key differences in the interpretative approaches followed by the IISD and the Tribunal. First, for purposes of determining whether two investors are "in like circumstances" under 1102, the IISD argued that a competitive relationship between the two investors is a relevant element but that regulatory-based differences should also be taken into account. However, the Tribunal took fully on board the more radical (and original)[52] view advanced by the United States that focused the relevant comparison on "identical" investors. One could well argue that following *Methanex*, it may be difficult to bring a claim under Article 1102 alleging *de facto* discrimination.

Second, with regard to the issue of determining whether the California's measure was expropriatory in nature for purposes of Article 1110, the Tribunal did not chose the approach based on the measure's *bona fide* purpose advanced by the IISD (as well as the United States), although it did reject Methanex's effect-based approach. The *Methanex* Tribunal's interpretation of the notion of a "measure tantamount to expropriation' appears to substantially restrict the scope of the "regulatory expropriation" concept.

It is indeed curious that the *Methanex* Tribunal's interpretation of the two key substantive provisions at issue was stricter than that advanced in the IISD's *amicus* brief. Without going beyond the limited scope of the present analysis, one can argue that the *Methanex* Tribunal's strict approach may be the consequence of a broader "reassessment" of the boundaries of international investment law. Particularly in North-America (and within the context of NAFTA), criticism against the legal protections extended to foreign investors by international treaties (including the secrecy of the arbitration process)[53] has been the loudest and most visible. Such criticism has certainly been voiced by "global society" as represented, for example, by the NGOs involved in the *Methanex* arbitration. Equally, such criticism has been heard in domestic political institutions and ultimately has produced a "reorientation" of national investment policies. Within the context of NAFTA, for example, there have been (1) a Note of interpretation by the Free Trade Commission regarding "access to documents" submitted to, or issued by, a Chapter 11 tribunal and the "meaning of the fair and equitable treatment standard" (2001) and (2) a Statement of the Free Trade Commission on "non-disputing party participation" (2003). At the unilateral level, both the United States and Canada have adopted new model

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[52] It appears that *Methanex* has been the first case where the concept of "in like circumstances" has been interpreted in this manner. See Federico Ortino, *From Non-Discrimination to Reasonableness: A Paradigm Shift in International Economic Law?*, Jean Monnet Working Papers (1, 2005).

[53] See Barton Legum, *Lessons Learned from the NAFTA: The New Generation of US Investment Treaty Arbitration Provisions*, 19 ICSID Review FILJ 344 (2, 2004) at 349-50.

BITs recognizing the admissibility of *amicus curiae* briefs[54] and restricting the scope of "fair and equitable treatment" and "expropriation" provisions (2004).[55]

This reorientation at the political and treaty-making levels has undoubtedly influenced investment tribunals practice and the *Methanex* award, it is submitted here, is the clearest example of such influence.

D. Conclusions

The *Shrimp/Turtle* and *Methanex* disputes demonstrate the role played by civil society in shaping international economic law. Although none of the central issues examined were decided on the exclusive basis of the arguments advanced by in the *amici* briefs, it is a fact that both tribunals' interpreted key provisions of GATT and NAFTA chapter 11 in an unbiased manner. Whether in the context of determining the admissibility of *amicus curiae* briefs, the scope of the general exception provision in GATT Article XX, the interpretation of the national treatment obligation in Article 1102 NAFTA or the definition of "regulatory expropriation" for purposes of Article 1110 NAFTA, both the Appellate Body in *Shrimp/Turtle* and the *Methanex* Tribunal clearly took into account the non-economic considerations and values at issue in the two disputes (at times even going beyond the legal positions put forward by the *amici*).

While the direct link between the *amici* briefs and the tribunals' decisions may appear (and is indeed) tenuous, the impact of civil society on international economic law should be appreciated in a broader context. In their effort to strengthen the legitimacy of their respective legal systems, the WTO Appellate Body and the NAFTA Tribunal permitted civil society to participate via the apparently rather harmless instrument of *amicus curiae* briefs. However, the participation of *amici* in the two dispute settlement proceedings symbolized, for the two tribunals, the existence of apparently unrepresented stakeholders with a key interest in the outcome of the balancing exercise inherent in the application of international economic law. In other words, while the two tribunals only allowed *amicus curiae* briefs, they in fact open the doors to a much broader, non-economic perspective that they then could not ignore.

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54 See Art 28 US model BIT.

55 See Art 5 and 6 (and Annex A and B) US model BIT.

The Constitutionalism of International Economic Law

Thomas Cottier[*]

A. The Structure and Nature of Economic Law

Economic law, as a branch of law, emerged from the traditions of commercial law, private and administrative law, in response to the regulatory needs of the post-World-War-II mixed economies and the welfare state.[1] Next to human rights and constitutional law, which predominantly shaped post-war legal orders, economic law amounts to a prime and precious public good upon which the human rights, welfare and prosperity of millions of people critically depend. It essentially defines the scope of opportunities for individuals and of distributive justice in a given society. Much ink has been used in attempts to define its scope and nature more precisely – to no avail.[2] The field entails a wide range of subjects, encompassing rules on companies, business transactions, taxation, competition, government procurement, investment, intellectual property, regulation of trade and finance, securities and monetary law, protection of health and the environment and labour relations. It deals with a wide range of actors: companies, producers, consumers, workers, and citizens. Horizontally, it cuts across the classical divide of private and public law. Core areas of private law, in particular contracts and torts, are of key importance to economic law. Likewise, constitutional law and administrative law deeply inform the shape and operation of economic law. Education and health care, and thus prime areas of governmental and para-statal activities in most countries are an essential prerequisite to the successful operation of economic law. In fact, almost any field of law, including penal law, is of relevance to economic relations.[3] Vertically, economic law entails regulations on all layers of governance: local, national, regional and international. It has been at the forefront of the globalization and regionalization of law, the centre of which was formerly within the nation state. European Community law emerged first and foremost as economic law. Most areas of domestic economic law today find partial correlations in international law which, in turn, feeds back into domestic law. International trade law,

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1 Andreas Kellerhals, *Wirtschaftsrecht und europäische Integration* (Zürich, Nomos/Schulthess, 2006) 29 et seq.

2 Kellerhals (n. 1 above), 29; Schluep e.g. defined economic law as "law of the economy", see Walter R. Schluep, *Was ist Wirtschaftsrecht?,* in Riccardo Jagmetti and Walter R. Schluep (eds.), *Festschrift für Walther Hug zum 70. Geburtstag* (Bern, Stämpfli Publishers, 1968) 25-95; see also Andreas Kellerhals, *Wirtschaftsrecht als Recht der Wirtschaft,* in Andreas Kellerhals (ed.), *Aktuelle Fragen zum Wirtschaftsrecht: zur Emeritierung von Walter R. Schluep* (Zürich, Schulthess Polygraphischer Verlag, 1995) 5-30.

3 Karl M. Meessen, *Wirtschaftsrecht im Wettbewerb der Systeme* (Tübingen, Mohr Siebeck, 2005) 14 et seq.

albeit considered marginal for a long time, has moved centre stage with the World Trade Organization (WTO) in addressing and harnessing globalization. Economic law thus stands for a complex phenomenon of principles, rules and regulations dealing in a very broad sense with the legal structures and procedures relating to the production, trade and consumption of goods and services, both domestic and international. It employs a wide range of regulatory approaches, which will be discussed shortly.

There is no point in seeking to define the subject matter of economic law more precisely. New areas may be added as policy makers so decide. No inferences can be drawn from notions defined in the operation of the law. It is sufficient to recall the diversity and breadth of topics to be considered. This, of course, renders the task of this paper rather difficult, if not impossible. An assessment of the impact of economic law, even though limited to international economic law, on state and society is impossible to achieve in specific terms. Such work requires the detailed analysis of distinct and widely divergent regulatory areas. Given these constraints, the paper thus seeks to focus on a number of structural issues in order to assess their impact on state and society. It first turns to the dichotomy of harmonization and regulatory competition. The second part then elaborates the constitutional functions of international economic law. In the third part, it addresses the impact and implications of basic principles of non-discrimination on structures of governance such as state sovereignty. In doing so, it mainly focuses on the law of the World Trade Organization. Part five turns to the impact on society especially the problems of international distributive justice, as one of the main challenges, and asks how the problem could be addressed in terms of structure and procedures both on the international and domestic levels of governance. The paper concludes with an overview of some of the challenges ahead.

B. Regulatory Competition versus Harmonization

The nation state has been built upon the idea of harmonization of law, creating equal conditions of competition for all actors within its jurisdiction. Economic law emerged after the period of the great civil law codifications, and its rules are scattered in a great variety of different instruments and sources. Fragmented as it is, it nevertheless seeks to bring about harmonization within states. Internationally, nation states largely operate under the doctrine of regulatory competition. While it is questionable to depict nations competing in economic terms, nation states define conditions of competition for their operators relevant for domestic and export markets. They protect domestic industries and consumers in the mercantilist tradition of the emerging nation state and they promote exports. Or, they expose producers, to the benefit of consumers, to foreign competition by reducing or eliminating trade barriers. Mixed regulatory forms can be observed within federal states. On the one hand, they centralize and harmonize and on the other hand, they operate under decentralized regulatory competition, for example in taxation. Constitutional principles, such as economic freedom, or the interstate commerce clause, arbitrate between the two approaches and seek to render them compatible, channelling regulatory competition.

The same pattern can be observed in international economic law. The structure of EC-law follows the logic of mixing regulatory competition and harmonization of law. The four freedoms channel domestic law, combating discrimination and regulations that are

excessively restrictive to the extent that they serve protectionist purposes which cannot be justified by legitimate policy goals and competing legal principles, in particular human rights. Regulatory approaches range from full harmonization in ordinances and exclusive central competence, to partial harmonization in directives, to the principles of equivalence, mutual recognition and home-state rule (Cassis-de-Dijon) and, finally, to classical forms of international reciprocity and cooperation. On the global level, the law of the WTO shows similar patterns. The principles of non-discrimination, which will be discussed shortly, channel domestic law with a view to creating equal conditions of competition for domestic and foreign products alike.[4] WTO law partly harmonises the law, such as rules on trade remedies or intellectual property protection in terms of minimal standards. To a large degree, however, it operates on the principle of progressive liberalization, defining market access in individualized schedules, taking into account levels of social and economic development. This is true both for tariffs and services. Equivalence and mutual recognition are much less present as the global system cannot be compared to the high levels of integration witnessed within nations and within the European Union. On an international level, mutual recognition agreements are typically concluded on either a bilateral or a regional basis. Since the Uruguay round, the WTO has developed from mere negative integration to some basic approaches of positive integration for example in the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs).

Beyond formal harmonization and regulation, economic law of large market powers exerts considerable influence in bringing about *de facto* harmonization and rapprochement. In this field, the traditions of comparative law loom large. Switzerland is a case in point. Situated at the crossroads of Latin and Germanic cultures, its laws have always been strongly influenced by both cultures. More recently, EC-law – often amalgamating these traditions, including Anglo-Saxon law and the traditions of Nordic law – is being adopted unilaterally under so-called policies of eurocompatibility, notwithstanding that Switzerland is not formally a member of the Union. In addition to bilateral agreements, formally importing EC-law under the guise of equivalence and in the form of mainly static international agreements to preserve formal sovereignty and independence, EC-law has thus become a major reference point in Swiss legal developments, bringing about substantial *de facto* harmonization with community law.[5] Exemptions exist only in sensitive areas and niches, such as banking regulations and taxation. In turn, deviations and off-shore policies are under increasing pressure to the extent that they harm Member States of the Union. Many countries around the world seeking access to the large and prosperous EU market face similar challenges and as a result they adopt policies comparable to those of the EU. These informal influences are not limited to small and medium-sized countries

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4 For more on the principles of non-discrimination see Thomas Cottier and Matthias Oesch, *International Trade Regulation* (Bern/London, Cameron May, 2005) 346 et seq.

5 Thomas Cottier, Daniel Dzamko and Erik Evtimov, *Die europakompatible Auslegung des schweizerischen Rechts*, in Astrid Epiney, Sarah Theuerkauf and Florence Rivière (eds.), *Schweizerisches Jahrbuch für Europarecht 2003* (Bern, Staempfli Publishers, 2004), 357-392; Thomas Cottier and Matthias Oesch, *Die sektoriellen Abkommen Schweiz – EG – Ausgewählte Fragen zur Rezeption und Umsetzung der Verträge vom 21. Juni 1999 im schweizerischen Recht* (Bern: Staempfli Publishers, 2002); Thomas Cottier and Erik Evtimov, *Die sektoriellen Abkommen der Schweiz mir der EG: Anwendung und Rechtsschutz*, in 139/2 Zeitschrift des Bernischen Juristenvereins (2003), 77-120.

strongly dependent upon access to larger markets. For example, European companies operating in the United States stock markets are bound to respect new accounting standards under the Sarbanes-Oxley Act, exerting considerable structural influences on such companies incorporated under European domestic law. It remains to be seen to what extent the Act will exert long-term effects on European regulations and competitiveness. It is unclear at this stage whether the Act will lead to efforts at harmonization or whether it will reinforce the traditions of regulatory competition in the field of company law.

Formal and informal pressures to adjust to rules and regulations of major markets thus amount to an important feature of today's economic law. It may be the modern tool and form for building empires. International economic law, formally linking different regulations and jurisdictions, is perhaps no more than the tip of an iceberg within the universe of economic law. It begs the question of how these processes influence allocation of powers in real terms. Evidently, they profoundly challenge the traditional perceptions of national sovereignty and independence of states. Hence, the question arises of how the international system as a whole should respond to them in terms of allocating formal decision-making powers. The problem thus turns into one of constitutional law. It goes way beyond how it has traditionally been perceived as constituting the sovereign nation state under the Westphalian system. Economic law, however defined, profoundly challenges traditional patterns. It calls for a new doctrine of constitutionalism. At the same time, international economic law exerts a profound influence on societies at large. Globalization and regionalization shape the workplace, lifestyles, opportunities, and costs alike. The complexity of the law leaves many people puzzled and destabilized. Largely unknown to the public at large, it is often subject to populist movements calling for enhanced protection and revival of national virtues. These concerns, in return, feed back into the realm of constitutional structures. They need to be taken into account in shaping new doctrines of governance able to cope with the challenge of globalization.[6]

C. Constitutional Functions of International Economic Law

Within the myriad rules and regulations of international economic law, a few fundamental rules stand out. They amount to basic principles of law, deriving from the principle of equality and they are of a constitutional nature, establishing the very foundations upon which a particular regime is based.[7] For the WTO, these principles relate to non-discrimination in its different forms. They include principles of transparency and access to legal protection, all seeking to bring about equal conditions of competition for foreign and domestic products alike. They are fundamental in addressing and avoiding rent-seeking protectionism by nation states. In EC-law, these principles are embodied in the Four Freedoms – free movement of goods, of services, of capital, and free movement of

6 Thomas Cottier, *The Impact from Without: International Law and the Structure of Federal Government in Switzerland*, in Peter Knoepfel and Wolf Linder (eds.), *Verwaltung, Regierung und Verfassung im Wandel. Gedächtnisschrift für Raimund E. Germann/Administration, gouvernement et constitution en transformation. Hommage en mémoire de Raimund E. Germann* (Basel, Helbing & Lichtenhahn, 2000) 213-230.

7 Daniel Thürer, *Kosmopolitische Verfassungsentwicklungen*, in Daniel Thürer (ed.), *Kosmopolitisches Staatsrecht* (Zürich, Schulthess, 2005) 3-39.

persons and establishment. While the substantive principles of the WTO are essentially limited to non-discrimination, the Four Freedoms also include the principle of proportionality of a regulation, transgressing *de jure* and *de facto* discrimination. In WTO law, proportionality applies in effect in assessing restrictions imposed on non-discrimination in the pursuit of other legitimate policy goals, in particular public health and environmental protection. Overall, however, WTO-law does not amount to levels of protection and integration comparable to those of EU-law or domestic constitutional law. The basic functions of the fundamental rules, however, are comparable. Importantly, they share structural traits with established principles of domestic constitutional law.

Principles of non-discrimination as well as market freedoms have important horizontal and vertical effects. The principle of most-favoured-nation (MFN) treatment, an expression and variation of the principle of non-discrimination, ensures that all benefits granted to a third party are immediately and unconditionally extended to all members of the WTO agreements. MFN, in other words, ensures equal conditions for all imported like products on a particular market.[8] Lawful exemptions exist, but need to comply with a number of criteria seeking to reduce trade distortions. The principle of national treatment, the other important expression of non-discrimination, compares foreign and domestic products. It requires that competing foreign products are not treated less favourably than like or substitutable domestic products. Again, important exemptions exist, and they also need to meet certain criteria and requirements. Both these principles thus operate as a check on domestic policies and law. Likewise, the principles of transparency, in particular those relating to the publicity of rules and regulations, and the right to seek judicial review of domestic determinations in trade policy, have structural effects in domestic law, as they require and prescribe minimal procedural standards which Members need to meet.[9] Other prescriptive rules of international economic law have similar effects. But more than anything else, non-discrimination and transparency exert a structural impact on domestic law which applies across the board. They establish a vertical relationship between the principles of international economic law and domestic law. Such a relationship, it is submitted, is comparable to the structural effects found in constitutional law. The freedom of economic activity (*Wirtschaftsfreiheit*) in the European constitutional tradition, or the right to establishment, offer comparable checks not only on federal law, but also, and perhaps most importantly on the law of sub-federal entities. In that respect, they are comparable to the function of the Interstate Commerce Clause in the US-Constitution and the due process clauses, requiring sub-federal units to meet certain procedural standards.

A functional comparison of these principles allows them to be considered as part of an overall and mutually supportive constitutional structure.[10] They have comparable functions in relation to different layers of governance. We may refer to this as a five-storey house, with local, cantonal, national, regional and international or global layers of law. States may not distinguish different layers within their jurisdiction. They may not be part

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8 Cottier/Oesch (n. 4 above), 346 et seq.

9 See e.g. Background Note on Provisions on Procedural Fairness in Existing WTO Agreements (WT/WGTCP/W/231), available at http://www.wto.org/english/tratop_e/comp_e/wgtcp_docs_e.htm (last visited June 19, 2008).

10 Thomas Cottier and Maya Hertig, *The Prospects of 21st Century Constitutionalism*, in Armin von Bogdandy und Rüdiger Wolfrum (eds.), in 7 Max Planck Yearbook of United Nations Law (2002), 261-322.

of regional integration, but there are at least the two layers of domestic and international law which interact in the same vein.

D. Multilayered Governance and the Impact on State Sovereignty

The principles of non-discrimination, much like the four freedoms in EC law, operate as a check on nation states and the sub-federal levels. In doing so, an additional layer of governance is established on the international level.[11] Such governance is exercised in and by the application of constitutional principles, adjudication and dispute settlement and the authority granted to enforce rights by means of trade sanctions and the withdrawal of market access rights of the infringing party. This layer also entails legislative work in and by treaty negotiations. Rules further elaborate the principles of non-discrimination and transparency. They go beyond those basic principles and have entered into legal harmonization. These rules are based upon authority delegated by Member States by means of international agreements. At heart, they essentially seek to prevent and remedy failures that have arisen within nation states, the political process of which inherently privileges domestic producers and tends to neglect interests relating to imported products which are much less well represented in the political process of domestic decision-making operating under democratic majority rule or strong executive powers. Economists have called this the lock-in effect of international economic law,[12] binding governments to comply with existing commitments and therefore being more successful in fending off protectionist claims. From the point of view of constitutional law, the functions are similar to those of constitutional rights which operate as a check not only on national legislation, but also on the courses of action taken at the sub-federal levels. Similarly, these rights lock-in these levels of governance and balance majority-based national and sub-federal laws and policies which may be in violation of these rights and principles. It is very important to recognize the compensatory function of WTO-principles and rules. They are profound emanations of the rule of law and the protection of legitimate expectations. By dividing political power among different levels of action and among different actors, they provide checks and balances on a vertical level.[13] In doing so, they contribute to the overall legitimacy of the system of multilayered governance, even though they may cut against majority ruling and thus seemingly be at odds with democratic principles. They are a public good of profound and critical importance.

Equating domestic and international law in terms of constitutional law is highly controversial. Constitutional scholars insist that that constitutional law is inherently limited to the nation state and the prerequisite of a homogeneous society.[14] It cannot be

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11 Cottier/Hertig (n. 10 above), 299 et seq.

12 Thomas Cottier, *From Progressive Liberalization to Progressive Regulation in WTO Law,* in 9 Journal of International Economic Law (2006), 779-821, 805.

13 Anne Peters, *The Globalization of State Constitutions,* in Janne Nijman and André Nollkaemper, *New Perspectives on the Divide Between National and International Law* (Oxford, Oxford University Press, 2007) 251-308, 273.

14 For Swiss authors see e.g. Andreas Auer, Giorgio Malinverni and Michel Hottelier, *Droit constitutionnel suisse* Vol. I (Bern, Stämpfli Publishers, 2006), 1. See also Cottier/Hertig (n. 10 above), 276 with further references.

extended to the realm of international law and a world highly fragmented and short of shared values and culture. Moreover, WTO law is frequently challenged from the point of view of democratic legitimacy.[15] It is argued that the diplomatic process, followed in rule making and even legal harmonization, is not sufficiently inclusive and deliberative in relation to stakeholders, in particular non-governmental organizations defending the global commons. Similar arguments of democratic deficiencies are made in relation to the European Union.[16] It is argued that the enhanced role of the European Parliament in legislation under the treaties following Maastricht, in particular the Reform or Lisbon Treaty, still fails to remedy the deficit in light of a lack of homogeneity in the European society and public at large comparable to the nation state.

The doctrine of multilayered governance, on the other hand, seeks to understand the overall regime in comprehensive constitutional terms. It seeks to interface different layers of governance and to bring about greater coherence. The effort is not meant to challenge traditional perceptions of constitutional law. Rather, it seeks to bring about an overall regime which is able to preserve and protect the very values post-war constitutionalism sought in the age of globalization.[17] While profound differences remain between different layers of governance in terms of decision-making, it is submitted that all layers share common features and principles as they are all human endeavours, responding to comparable problems of human interaction. They all share common principles and traits many of which emerged in economic and international economic law. An overall and comprehensive understanding of constitutionalism also allows the identification of complementary and compensatory functions and areas where further work and rapprochement of different layers is needed in terms of decision-making processes. Thus, efforts to enhance inclusiveness can and should be made, in particular where the law is led into harmonization and exceeds the operation of constitutional principles. The legitimacy of the WTO principles of non-discrimination and transparency, however, is firmly based upon the idea of rule of law and equality. They are inherently legitimate and do not need additional support by means of democratic processes of decision-making.[18] Their operation makes an important contribution to fair relations among nations and to

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15 For an overview of the debate on the legitimacy of WTO law see e.g. Manfred Elsig, *The World Trade Organization's Legitimacy Crisis: What Does the Beast Look Like?,* in 41 Journal of World Trade (2007), 75-98; Daniel Esty, *The World Trade Organization's legitimacy crisis,* in 1 World Trade Review (2002), 7-22; Markus Krajewski, *Democratic Legitimacy and Constitutional Perspectives of WTO Law,* 35 Journal of World Trade (2001), 167-186; Eric Stein, *International Integration and Democracy: No Love at First Sight,* in 95/3 American Journal of International Law (2001), 489-534.

16 Andreas Føllesdal and Simon Hix, *Why there is a democratic deficit in the European Union. A Response to Majone and Moravcsik,* in European Governance Papers No. C-05-02 (2005), available at http://www.connex-network.org/eurogov/pdf/egp-connex-C-05-02.pdf (last visited June 19, 2008); Christophe Crombez, *The Democratic Deficit in the European Union: Much Ado about Nothing?,* in 4 European Union Politics (2003), 101-120; Winfried Kluth, *Die demokratische Legitimation der* EU. *Eine Analyse der These vom Demokratiedefizit der Europäischen Union aus gemeineuropäischer Verfassungsperspektive* (Berlin, Duncker und Humblot, 1995).

17 Cottier/Hertig (n. 10 above), 299 et seq.

18 Anne Peters, *Die Strukturähnlichkeit der Diskriminierungsverbote im Menschenrechtsbereich und im Welthandelsrecht,* in Stephan Breitenmoser *et al.* (eds.), *Human Rights, Democracy and the Rule of Law: Liber Amicorum Luzius Wildhaber* (Zürich/Baden-Baden. Dike, 2007) 551-593.

the protection of minorities not sufficiently represented in domestic political processes. They are important ingredients in keeping the peace among nations – a key ingredient and task of international law.[19] Per se, by their very operation, and based upon past experience, they contribute to enhancing the welfare of nations. Just as much as fundamental constitutional rights, they are inherent to democracy and good governance. They stand for the rule of law, and in many countries, the principles of international economic law in fact operate as a surrogate for domestic constitutional structures and make up for the lack of transparent political processes and an independent judicial branch. They shape the political process, but may at times oppose majority ruling in defence of individuals. Like fundamental rights, they primarily rely upon on due process and fair judicial avenues and enforcement. In the case of the WTO, principles of non-discrimination are essentially enforced by the dispute settlement mechanism. The Dispute Settlement Understanding with its two-tier system of panels and Appellate Body review offers the most advanced and successful system of dispute settlement in international law. The fact that most rulings are swiftly implemented by governments[20] provides evidence of high levels of acceptance and thus the legitimacy of the system.

The law of the WTO thus exerts a profound influence on domestic processes and structures. It limits the regulatory freedom of governments in the pursuit of particular interests of nations. Like EU law, WTO law has a strong impact on traditional patterns of state sovereignty. Indeed, the perception of multi-layered governance in international economic law requires new perceptions of sovereignty.[21] While EU Members clearly find themselves in an era of post-nation states, strongly embedded in economic law of the Union, it is less clear to what extent WTO law, in principle, exerts comparable effects, albeit to a lesser degree.

Principles of international economic law are largely treaty-based. From a formal point of view, the sovereignty of nations is not affected as they have consented to the application and enforcement of these rules, entailing limitations to the exercise of political discretion on domestic affairs. It is a matter of calculated transfer of sovereignty and not – as some politicians, especially from the national conservative perspective argue – a loss of sovereignty. On substance, however, the principles and the body of WTO law have profound implications on the structure of domestic governance. The emerging system of multilayered governance brings about important changes in the allocation of powers, without changing a word of the domestic constitutions. This is also true for informal influences on domestic policies, such as the unilateral modification of national law to achieve harmonization with the law of other, larger market economies.[22]

Firstly, the operation of the WTO essentially enhances the role of the executive branch of government. Negotiations are led by administrations and diplomats, primarily responsible to the executive branch. The know-how to lead negotiations is vested in these bodies. In the design of new legal regimes relating to international economic law, the role of legislators is reduced as a corollary. Except for in the United States, for

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19 Thomas Cottier and Alexandra Dengg, *Der Beitrag des freien Handels zum Weltfrieden,* in 81 Basler Schriften zur europäischen Integration (2007), 41-70.

20 William J. Davey, *The WTO Dispute Settlement System: The First Ten Years,* in 8 Journal of International Economic Law (2005), 17-50.

21 John H. Jackson, *Sovereignty, the WTO and Changing Fundamentals of International Law* (Cambridge, Cambridge University Press, 2006).

22 See above page 4.

decades parliaments have not been much interested, or involved, in the formation of international economic law.[23] As the subject mainly dealt with issues of co-existence and cooperation among states, domestic law was not substantially affected. The focus on non-tariff barriers has inherently led treaty-making to deal with matters of domestic concern, ranging from domestic support in agriculture to intellectual property rights and regulatory regimes of services. Rules have increasingly affected other policy areas and limited the powers of legislators to adopt regimes of their liking. More and more, the main structural elements of a regime are predetermined by international rules and principles. They leave parliaments and legislators dependent upon solutions agreed to by the executive branch on international layers of governance. As a result, the power allocation between the executive branch and legislators shifts further, in addition to important domestic functions of administrations in preparing legislation. The power to consent to important agreements remains. However, as such agreements cannot be unilaterally changed, and often come as part of a package-deal, parliaments are left with the option either to take or leave the matter – the latter often being linked to substantial political costs. The development of international economic law has thus been at the forefront in increasing the role and powers of parliaments in the process of preparing treaties, and during the treaty-making process. Procedures of informal consultation and participation in delegations emerged commensurate with the particularities of different constitutional settings. Except for the United States Congress, democratic control of international trade policy and law has not been substantially reinforced in most countries, and much work still lies ahead as international economic law grows further in the process of globalization.

Secondly, international economic law potentially enhances the role of courts.[24] The traditional reluctance to deal with foreign affairs and instead to leave them to the executive branch as a matter of international relations, is no longer acceptable. Moreover, traditional restraints to reviewing domestic economic legislation in the field of administrative law, limiting control to *ultra vires* and excess of discretionary powers, no longer match the detailed review of legislation and decisions which takes place under the Dispute Settlement Understanding of the WTO. It results in what we have called a paradox of judicial review. Courts therefore are bound to expand substantive review and to develop adequate standards of review which are compatible with the overall system of multilayered governance. In this context, there is significant controversy over the extent to which they should turn towards giving principles and rules of international economic law direct effect, beyond the doctrine of consistent interpretation.[25] WTO law does not oblige Members to impose direct effect in their domestic legal systems. In the United States, courts are barred by legislation from giving direct effect to WTO law. The European Court of Justice, essentially adopting a judicial policy of reciprocity, has ruled likewise; furthermore it excluded direct effect of adopted WTO decisions as a

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[23] For Switzerland see e.g. Matthias Oesch, *Gewaltenteilung und Rechtsschutz im Schweizerischen Aussenwirtschaftsrecht,* in 105 Schweizerisches Zentralblatt für Staats- und Verwaltungsrecht *(ZBl)* 2004, 285-321.

[24] Thomas Cottier, *The Judge in International Economic Relations,* in Mario Monti *et al.* (eds.), *Economic Law and Justice in Times of Globalisation – Wirtschaftsrecht und Justiz in Zeiten der Globalisierung, Festschrift for Carl Baudenbacher* (Baden-Baden, Nomos, 2007) 99-122.

[25] Thomas Cottier, *A Theory of Direct Effect in Global Law,* in Armin von Bogdandy *et al.* (eds.), *European Integration and International Co-ordination. Studies in Transnational Economic Law in Honour of Claus-Dieter Ehlermann* (The Hague, Kluwer Law International, 2002) 99-123.

foundation for claims to compensation and state responsibility. The issue of direct effect is often dealt with as a technical issue of treaty interpretation. Traditional standards applied elsewhere, essentially rely upon an assessment as to whether the rule in question is sufficiently clear and precise. Research shows that the assessment should be based upon the concept of justiciability.[26] Courts should assess whether an issue is suitable to be decided by courts and judicial proceedings. Answers do not inherently depend upon the formulation of principles and rules. Rather, the question is whether the subject matter falls within the constitutional provinces of the court and whether courts are best suited to assess the matter. This implies an analysis in terms of separation of powers and checks and balances under a given constitutional system. It entails determination of judicial policies in terms of restraint and activism. It also entails issues of excluding direct effect on the basis of a political questions doctrine. Importantly, the approach allows more nuanced replies to be given than the current wholesale exclusion of direct effect which we find in US and EC law. While direct effect will be given in some constellations, it will be refused in others, leaving implementation to the legislator or the executive branch. Issues having major policy and financial implications in international economic law will be left to these bodies. Others, the implications of which are contained or related to procedural issues, may well fall within the province of the courts commensurate with their respective positions in a given constitutional system. A new generation of judges will have to leave past hands-off approaches behind them and find their proper and coherent role in multilayered governance.[27]

These repercussions indicate that international economic law has not remained without substantial impact on the structure of states, in particular the allocation of powers among the different branches of government. However, these shifts do not affect the strong position of states on the whole. It is often argued that globalization and the shift of law making to international bodies substantially reduces the scope and power of states. The evidence does not support this assertion. States remain in control of international law making; the WTO like the other international organizations outside the European Union lacks supranational powers. The process in these international organizations is still member-driven and decisions essentially depend upon consensus of powerful states. While the US and the EU were able to control the process up to the conclusion of the Uruguay Round in 1993, subsequent negotiations under the Doha Development Agenda have included emerging economies, in particular Brazil, India, and China as additional critical players. The world of international economic relations again is multipolar. Yet, the critical role is not limited to these leaders. The activities of all states have been growing; they are assuming more responsibilities, rather than fewer – despite the rhetoric of neo-liberalism. The process of liberalization calls for adequate and strong safety nets, protecting citizens during the processes of economic transformation and adjustment. Liberalization of markets has to go hand in hand with welfare policies. Where they fail or are nonexistent, liberalization and division of labour are bound to be rejected in the political process. Moreover, international economic law depends upon implementation and enforcement by states. Within a system of multilayered governance, the bulk of powers and work is bound to remain with democratically elected governments and thus

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[26] Daniel Wüger, *Anwendbarkeit und Justiziabilität völkerrechtlicher Normen im schweizerischen Recht: Grundlagen, Methoden und Kriterien*, Diss. (Bern, Stämpfli Publishers, 2005); Thomas Cottier (ed.), *Der Staatsvertrag im schweizerischen Verfassungsrecht* (Bern, Stämpfli Publishers, 2001).

[27] Cottier (n. 24 above), 122.

the State. Other layers of governance, including the EU, continue to depend largely upon Member States for the purpose of implementation of law and realization of policies. International economic law, however, induces a review of the traditional patterns of allocation of powers. Much of this will be a matter of practical experience, of trial and error, rather than formal changes to the charters of national constitutions. Some procedural requirements may be induced by international economic law itself. We shall return to this below in the examination of the structural impact of international economic law on society.

E. The Impact on Society

Societies show widely diverging levels of economic and social development. Moreover, they have varying attitudes to law and to compliance with it. As for states, it is therefore impossible to assess the impact of international economic law except in very general terms, and from a structural perspective. WTO law is not an end in itself. It serves the purpose of enhancing human welfare and sustainable development and growth while preserving and protecting the environment and the exhaustible natural resources of the globe.[28] Within WTO law, these goals are pursued by means of progressive liberalization and regulation of international trade in goods and services and thus a philosophy of welfare-enhancing international division of labour. Ever since the GATT entered into force in 1947, tariffs on industrial goods have been reduced from an average of 40% to some 4% in eight trade rounds.[29] Non-tariff barriers have been addressed and reduced, contributing to ever increasing levels of world trade. The progressive creation of equal conditions of competition has greatly enhanced global welfare in industrialized and service-based economies.[30] International trade has made a critical contribution to the wealth of nations and people since World War II. Societies have prospered and changed to an unprecedented degree – at the price of hard work and enhanced competition. Pressures to specialize and to reallocate labour have increased. In addition, the success of an open trading and investment system in creating overall growth and welfare has gone hand in hand with enhanced exploitation and depletion of natural resources, culminating in climate change. Environmental protection emerged as an area of vital importance and will increasingly influence and shape trade policy instruments.

While benefits are taken for granted, the need to adjust and restructure vulnerable sectors of the economy and the environment has called for protection and often translates into opposition to freer trade and open markets. While societies prosper, they suffer at the same time from losses of political control and self-determination as a result of opening of markets and exposure to structural changes. This "sense of vulnerability", or economic insecurity, has increased as the growing integration of states all over the world

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28 Preamble of the Marrakesh Agreement Establishing the World Trade Organization, available at www.wto.org (last visited June 19, 2008).

29 BBl 1994 IV 134, the chart is reprinted in Cottier/Oesch (n. 4 above), 74.

30 World Trade Organization, *World Trade Report 2007: Six decades of multilateral trade cooperation: What have we learnt?*, available at http://www.wto.org (last visited June 19, 2008); World Bank, *World Development Indicators 2007*, available at http://web.worldbank.org (last visited June 19, 2008).

into the international economic system has intensified competitive pressures.[31] Most people worldwide are still uncertain about the impact of the international economic integration on their personal life. As surveys from 2002 until today show, citizens believe that globalization will worsen environmental problems and poverty in the world.[32] Furthermore a majority fears that economic globalization reduces the number of jobs in their own country[33] and they claim that international economic integration is happening too quickly. These feelings are easily exploited in a populist manner and turned into conservative and even nationalist political capital. Despite this sense of vulnerability, the same polls indicate that most people expect that more economic globalization will be positive for themselves and their families. One can assume that the incertitude of most people about the impact of international economic law on their personal life corresponds with the lack of transparency and the incomprehensibility of international economic relations. Even though the work of the WTO has become more transparent, more has to be done to assure sufficient information and education.

Another, progressive line of thought calls for enhanced protection of human rights and labour standards abroad in order to preserve fair conditions of competition.[34] Since the People's Republic of China entered the WTO in 2001, these anxieties have increased. They also extend to developing countries.[35] Ailing industries' call for enhanced protection, and outsourcing in what is an increasingly flat world is opposed in order to protect jobs at home. Particular challenges exist in relation to agriculture, the primary and most conservative sector which also enshrines traditional values in most societies. For decades, this sector in industrialized countries has remained highly protected and sheltered from competition and global markets – creating profound imbalances, largely to the detriment of developing countries dependent upon exports in the primary sector. Today, the sector faces painful adjustment, being forced to leave traditions held dear in societies behind. The transition adds to the tensions and anxieties caused by the globalization of economic law and may widen divisions in societal structures.

Similar anxieties and tensions exist in developing countries,[36] even though negative sentiments about "economic globalization" are more prevalent in the rich countries of the North.[37] For decades, until the conclusion of the Uruguay Round and the entry into force of the WTO in 1995, they essentially did not have to make strong commitments under GATT. They generally remained sceptical about trade liberalization, supporting import substitution and calling for extended special and differential treatment which reduces obligations under WTO law. Eventually, and successfully, they called for lib-

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31 Jagdish Bhagwati, *In Defense of Globalization* (Oxford, Oxford University Press, 2004) 12.

32 The polls are carried out by the Canadian polling firm Globescan (until 2006: Environics International). The results of the surveys can be found at http://www.globescan.com/news_center.htm (last visited June 19, 2008).

33 Joseph Stiglitz, *Making Globalization Work* (London, Penguin Books, 2007) 67 et seq.

34 For more on this matter see the contributions in Thomas Cottier, Joost Pauwelyn and Elisabeth Bürgi (eds.), *Human Rights and International Trade* (Oxford, Oxford University Press, 2005).

35 Thomas L. Friedman, *The World is Flat* (London, Penguin Books, 2007).

36 The effects on developing countries are described in an impressive way in Friedman (n. 35 above), especially in chapter 10: The Virgin of Guadalupe.

37 This was a finding of an extensive poll on global public opinion on globalization in 2004. The press summary is available at http://www.globescan.com/news_archives/GlobeScan_pr_06-04-04.pdf (last visited June 19, 2008).

eralization of textiles and agriculture. They still are reluctant to liberalize services in return, fearing competition and loss of sovereign control over key sectors. Equally, and in their own way, they are confronted with painful adjustments. Current talks under the Doha Development agenda have faced obstacles to progress since 2001 due to conflicting interests in liberalizing agriculture in industrialized countries and services in developing countries.

In these processes, in industrialized and developing countries alike, international economic law not only faces the challenge of inducing growth and structural adjustment, but also the problem that it does not bring about *per se* fair distribution of income and wealth within countries.[38] Indeed, WTO law by and large treats Members as a black box. It does not ensure that benefits trickle down to all people alike. It is merely concerned with macro-economic growth of economies. It does not engage in domestic distributive operations. This task is left to domestic law and policy in industrialized and developing countries alike. While international economic law is a prerequisite for justice, fair distribution depends upon domestic constitutional structures of governance and values in society. Democracies tend to bring such distribution about; the wealthy are accepted as long as all strata of society gain from an open trading system. In many countries, however, income disparities have increased due to a lack of the middle classes and democratic governance. Increasing imbalances are politically attributed to international economic law and undermine its acceptance and legitimacy. The question thus arises of the extent to which international economic law should become more prescriptive and interventionist in domestic political processes. For example, it is striking to compare international levels of protection of intellectual property with the absence of international disciplines when it comes to real property.[39] International law is limited to investment protection and compensation in matters of expropriation and takings. It neither prescribes nor supports in law the creation of fair conditions in real property and land ownership. Many countries still do not have land registration in place, and property cannot be used as collateral for investment much needed in rural areas. International economic law could do more to support these foundations of prosperity and of fairness at home.[40]

In terms of impact on society, issues of legitimacy of WTO-rules therefore predominantly relate to the fate of populations in developing and least-developed countries. While welfare enhancing effects among industrialized countries are well established and widely recognized and negative effects can be absorbed by developed social policies,

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38 See e.g. Darrel Moellendorf, *The World Trade Organization and Egalitarian Justice*, in 36 Metaphilosophy (2005), 145; Thomas Pogge, *World poverty and human rights: cosmopolitan responsibilities and reforms* (Cambridge: Polity Press, 2003); Peter Singer, *One World: The Ethics of Globalization* (New Haven, Yale University Press, 2002) chapter 3; Stiglitz (n. 33 above), 61-101.

39 Thomas Cottier, *Geistiges Eigentum, Handel und nachhaltige Entwicklung. Erfahrungen und Perspektiven im Nord-Süd Verhältnis*, in *Das internationale Recht im Nord-Süd-Verhältnis: Referate und Thesen von Werner Meng et al.*, Berichte der Deutschen Gesellschaft für Völkerrecht Vol. 41 (Heidelberg, C.F. Müller, 2005) 237-274.

40 One approach to counteract these imbalances is offered by the cosmopolitan theory; see e.g. Simon Caney, *Justice Beyond Borders. A Global Political Theory* (Oxford, Oxford University Press, 2005); Ernst-Ulrich Petersmann, *European and International Constitutional Law: Time for Promoting "Cosmopolitan Democracy" in the WTO*, in Gráinne De Búrca and Joanne Scott (eds.), *The* EU *and the* WTO. *Legal and Constitutional Issues* (Oxford/Portland, Hart Publishing, 2001) 81-110.

serious doubts still persist in relation to developing and least-developed countries and thus a large group of some 100 countries. However, developing countries and transitional economies do better than often thought. Recent trends and statistics show that growth in exports of merchandise from developing and least-developed countries has outperformed that of rich countries (EU and US). As a consequence, in 2006, the export share of developing countries exceeded one third of total world exports.[41] Importantly, least-developed countries have been growing rapidly, mainly due to high mineral and petrol prices, but they started from such low levels that their share is still minor. Exports from least-developed countries still represent less than 1% of world trade.

Overall, the true weaknesses of the world trading system therefore lie in an inability to substantially stimulate growth and trade for least-developed countries. Although the WTO tries to differentiate between developed and developing countries with "special and differential treatment" provisions,[42] the system only takes effect once countries reach a certain level of development. The fact, for example, that there was a poverty reduction by more than 260 million people over 1990-2004 is mainly based on massive poverty reduction in China.[43] In many countries, inequality has increased. Countries therefore have to take off on their own. They obtain little support for doing so from international economic law. International trade law, based upon equal conditions of competition, reflects a liberal approach and fails to deal appropriately with those left out in the first place. Current developments which focus on preferential trade agreements among industrialized and emerging economies further reinforce such tendencies. The long-term legitimacy of the system therefore will depend upon enhanced capacities to fight poverty and to bring about substantial and effective aid for trade.[44] An open trading system is beneficial to all, provided that it brings about flanking policies for supporting least-developed countries in the process of diversification, product development and building international marketing skills. It cannot afford to leave issues of distributive justice within societies unheeded in the coming years and decades.[45]

F. The Challenges Ahead

The main challenges lie within countries and members of the international trading system. Domestic reform, capacity building and education need to prepare them for globalization. Yet, we are faced with the challenge of how best international economic law may support these efforts – beyond classical forms of concessionary aid. To what extent are rules of international law able to support the process?

Firstly, international economic law needs to reflect widely diverging levels of social and economic development. The principles of progressive liberalization in goods and

41 World Trade Organization, *World Trade Report 2007: Six decades of multilateral trade cooperation: What have we learnt?*, available at http://www.wto.org; World Bank, *World Development Indicators 2007*, available at http://web.worldbank.org/(last visited June 19, 2008).

42 See e.g. http://www.wto.org/english/tratop_e/devel_e/dev_special_differential_provisions_e.htm (last visited June 19, 2008).

43 World Bank, *World Development Indicators 2007*, 4 (n. 41 above).

44 See also Stiglitz (n. 33 above), 61-101.

45 Stiglitz (n. 33 above), 61-101.

services allow for individualization, but fail to apply in areas of standard setting and harmonization such as in the TRIPs agreement. Past and current philosophies of special and differential treatment for developing countries have largely failed,[46] with the exception of the unilateral concessions granted by industrialized countries under the Enabling Clause. These preferences are important, albeit they fail to cover all items of importance to developing countries. Although developing countries continue to seek enhancement and further exemptions, many of them (except emerging economies) have been left in a state of inferior and not fully integrated membership of the WTO, often in a less good position to combat domestic economic protectionism and rent-seeking due to the lack of international obligations in the field. The initiative of the EU to include everything but arms and the effort to multilateralize the approach are steps in the right direction.[47] Alternatives to special and differential treatment which reflect factual differences in the operation of the law much more effectively need to be found. International law has failed to establish operational and objective criteria to assess the status of countries under the doctrine of sovereign equality. The transitions between industrialized, emerging, transitional and developing countries are smooth and are not suitable to provide a foundation for making appropriate legal distinctions. Modalities of graduation should be found which allow taking economic factors and indicators into account in the process of applying and implementing rules of international economic law.[48] Wherever suitable, rules should be framed in a manner which allows such differences to be taken into account. Examples to this effect already exist in WTO law.[49] Future rules should build upon this model. A single set of rules, taking such factors into account, will allow automatic graduation to be brought about. In addition, recourse to scheduling and thus individualization may also offer alternative avenues in the field of non-tariff barriers. No longer will it be necessary to distinguish developed and developing countries, with the exception of least-developed countries which are legally defined by the United Nations. As Members develop, they should automatically graduate into fuller applications of WTO rules, securing fair competition on world markets. Prior to reaching the appropriate levels, they would be largely exempted from burdensome rules, such as advanced standards of intellectual property protection. They could focus on investment critical to sustainable development, such as education and nutrition.

Secondly, efforts need to be made to strengthen democratic rules, both on a national and international level, in order to bring about equitable distribution of growth and benefits. What would be the role for international economic law? Democracy begins at home. Members are bound to develop democratic structures, to adjust to globalizing economic structures in their own right and way.[50] International law is built upon the premises of national sovereignty and non-intervention. Yet, these concepts do not mean that states

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46 T. N. Srinivasan, *Nondiscrimination in GATT/WTO: was there anything to begin with and is there anything left?,* in 4 World Trade Review (2005), 69-95; Stiglitz (n. 33 above), 61-101.

47 Council Regulation 416/2001, *Amending Regulation (*EC*) No 2820/98 Applying a Multiannual Scheme of Generalised Tariff Preferences for the Period 1 July 1999 to 31 December 2001 so as to Extend Duty-Free Access Without any Quantitative Restrictions to Products Originating in the Least Developed Countries*, 2001 O.J. (L 60).

48 Cottier (n. 12 above), 779-821.

49 See the examples in Cottier (n. 12 above), 797 et seq.

50 For the debate on a possible "right to democracy" see e.g. Thomas Franck, *The Emerging Right to Democratic Governance,* in 86 American Journal of International Law (1992), 46-91; Gregory

and societies need to be dealt with in terms of black boxes. The world has moved into a system of legal and *de facto* multilayered governance which entails shared and enhanced cosmopolitan responsibilities. International law has come a long way in the field of human rights. No longer, and rightly so, is this a purely domestic affair since human rights violations not only violate fundamental values of human dignity, they also destabilize international relations and peace in the long run. The process of constitutionalization of international law is conceptually most advanced in this field, albeit it falls short of making available efficient mechanisms of enforcement. International economic law still follows the traditions of diplomatic protection and is limited to defending interests of foreign exporters and investors. It does not entitle domestic producers and consumers in a purely domestic context. Rules of transparency and judicial protection are limited to the protection of foreigners, although they may have important spill-over effects to the benefit of domestic traders alike. We need to think how the path of supporting domestic producers and consumers may be expanded in international economic law. Efforts to support the democratic processes in the field of economic regulations should therefore be made.[51] WTO law should be supplemented in terms of transparency to secure and bring about deliberate modes of trade policy formulation in Member States. It should give a voice to all those affected and thus reduce anxieties and feelings of being left out. Minimal standards as to hearing interested groups, and the formation of trade associations and labour unions in civil society should be created. Monitoring of compliance should be introduced. Trade policy reviews should also focus on domestic processes. Rights to participation may eventually lead to a mechanism of enforcement under the dispute settlement system of the WTO. Within the WTO, the creation of a parliamentary assembly has been discussed by the Inter Parliamentary Union.[52] It was endorsed by the International Law Association. In the process of reforming the structures of the WTO, rendering them more suitable for enhanced regulation as opposed to progressive liberalization in a globalized economy, a parliamentary assembly will be able to create important networks and linkages to national parliaments. It will assist a process in all countries alike of enhancing the knowledge and skills of Members or parliament to engage in competent and meaningful dialogue and debate with the executive branch of government. In modest terms, international economic law, focusing on domestic and international procedures, could thereby assist in the process of democratization upon which the legitimacy of international economic law has to be built to the extent that it goes into standard setting harmonization and beyond the inherent principles of non-discrimination, transparency and progressive liberalization.

H. Fox, *The Right to Political Participation in International Law,* 17 Yale Journal of International Law (1992) 539-607; Petersmann (n. 40 above).

51 Petersmann (n. 40 above), 94 et seq.

52 http://www.ipu.org/splz-e/trade03.htm (last visited June 19, 2008); see also Erika Mann, *A Parliamentary Dimension to the WTO – More than just a Vision?,* in 7 Journal of International Economic Law (2004), 659-665.

G. Conclusions

The impact of international economic law on state and society is profound. There is hardly an area in the vast field of economic law dealing with production and trade in goods and services which remains untouched by corresponding disciplines of international law, both on the regional and global levels. Its principles are at the heart of an emerging system and doctrine of multilayered governance, seeking to see governance on different layers in an integrated and better coordinated manner. They exert important checks and balances. They restrain protectionism, unfair conditions of competition and thus state failures, often induced by statal structures and domestic processes of decision-making and politics. They exert considerable de facto influence on statal and constitutional structures. Often, they amount to constitutional guarantees, enforceable in international dispute settlement. These principles and rules are public goods of the greatest importance in a globalizing world. They have stood the test of time for more than fifty years. At the same time, they show weaknesses which need to be addressed. International standards increasingly develop and shape domestic legislation, undermining the role of traditional legislation by challenging traditional patterns of governance and national sovereignty, without offering, at this stage, appropriate answers as to how these challenges could best be met in structural and procedural terms. While the field has been growing and expanding in recent decades, constitutional structures continue to operate under premises shaped for essentially autonomous, domestic and coherent societies. The dynamics of international economic law, responding to the needs of an internationalized and global economy, leaves us with major structural challenges. Peoples feel a loss of control and self-determination. Domestically, power shifts to the executive branch and leave us with the challenge of developing compensatory mechanisms in support of democratic legitimacy. Courts face the challenge of finding appropriate standards of review, leaving traditions of restraint in foreign and economic affairs behind with a view to overcoming what currently amounts to a paradox of stricter review on the international than on the domestic level.

While suitable to bring about growth and prosperity in industrialized and emerging economies, international economic law fails to be sufficiently inclusive for least-developed countries. A purely liberal model of creating equal conditions of competition is no longer sustainable. Without an effort to offer better opportunities and support to least-developed countries, the system leaves them marginalized and will fail to stand the test of morality and long-term legitimacy. Different avenues should be contemplated. Effective graduation is one of them. A second trait – applicable to all Members alike – reinforces deliberate democracy at home, building upon the traditions of transparency. More emphasis should be put on minimal procedural rules of democracy to be applied at home, and subject to monitoring and possibly dispute settlement in the WTO. These rules will assist in bringing about fair distribution of welfare at home. Finally, in restructuring international organizations, parliamentary assemblies should serve to support domestic processes and thus enhance democratic accountability and legitimacy of international economic law in the age of globalization. International economic law is too important a public good to be complacent about. It calls for reform in order to preserve achievements and to address deficiencies.

Chapter 2
European Union

Intra-EU Systems Competition

Werner Mussler[*]

A. Introduction: Systems Competition in the EU

From the perspective of systems competition, European integration has always been a rewarding object of analysis. This holds especially true for any kind of empirical research: Nowhere have there been better possibilities for testing the theoretical conjectures on the functioning of systems competition and of its (institutional) preconditions[1] than within the European Union. The reason for this is the particular institutional construction of the EU. It consists, on the one hand, of still completely sovereign national states and insofar differs from federal states like the U.S. or Switzerland where systems competition is also effective and empirically observable, but only within the state. On the other hand, the existing legal rules, especially the four economic liberties constituting the internal market, are a kind of institutional guarantee for systems competition: They allow, at least generally, for the free movement of production factors such as labour and capital. Free movement is the precondition of *exit* (or the threatening with exit), and exit is the core element of systems competition.[2]

EU history has been a history of systems competition. The process of integration shows, however, that systems competition can also be restricted effectively by political cartelization. Member states cannot only act as political competitors, they can also try to eliminate political competition. In the EU, a specific means of restricting systems competition is the centralization of political competences on the European level. In terms of systems competition, there are at least three strategies conceivable which the political actors in the member states can apply: They can (a) just behave as "fair" political competitors and cultivate their home turf. They can (b) try to exert influence on the political process on the EU level in order to take advantage for themselves; this kind of "unfair" competition which often results in EU legislation can be compared to the "raising rivals' costs" strategy of firms known from industrial economics.[3] And they can (c) eliminate competition through a cartel on EU level. Cases (b) and (c) have in common that the member states try to reduce competitive pressure by initiating EU legislation.

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[*] Dr. rer.pol. Werner Mussler, EU Correspondent, Frankfurter Allgemeine Zeitung, Brussels.

1 See, eg. W. Kerber, *Regulatory Competition and Competition Law,* supra p. 27-44; M. E. Streit and D. Kiwit, *Zur Theorie des Systemwettbewerbs,* in: M. E. Streit and M. Wohlgemuth (eds.), *Systemwettbewerb als Herausforderung an Theorie und Politik* (Baden-Baden, 1999) 13-48.

2 See generally W. Mussler, M. Wohlgemuth, *Institutionen im Wettbewerb: Ordnungstheoretische Anmerkungen zum Systemwettbewerb,* in: P. Oberender and M. E. Streit (eds.) *Europas Arbeitsmärkte im Integrationsprozess* (Baden-Baden, 1995) 9-45; W. Mussler, *Systemwettbewerb als Integrationsstrategie der Europäischen Union,* in M. E. Streit and M. Wohlgemuth (eds.), *Systemwettbewerb als Herausforderung an Theorie und Politik* (Baden-Baden, 1999) 71-102.

3 S. C. Salop and D. T. Scheffman, *Raising rivals' costs* (1983) 73 American Economic Review (Papers and Proceedings), 267-271.

However, (b) has definitvely a competitive element (member state A tries to get a competitive advantage in systems competition over Member state B) whereas in (c), there is no competition, there is merely the common interest of the member states to eliminate systems competition.

To understand which of the strategies is most probable under which circumstances – and thus conjecture about the potential outcome of the political game in the EU – requires some more information about the incentives and interests of the political actors. There are not only the representatives of the Member States to be considered, but also the members of the European Commission (and the bureaucrats there) and the members of the European Parliament. Finally, we should not forget the judges at the European courts since they had and have considerable influence on the rules which determine the functioning of systems competition in the EU.

The purpose of this paper, however, is not to further elaborate on the theory of systems competition in the EU. The author's competitive advantages in this field have probably gone a long time ago. Rather, he would present some kind of anecdotic empirical evidence, building up on his experience as a Brussels-based journalist. It may help to answer two questions: Under which conditions which political strategy seems to apply? And more generally: Is Intra-EU systems competition still at work? The outline of this paper is as follows. In Chapter B, we will sum up some theoretical and historical observations on how systems competition developed from the Rome to the Lisbon treaty. Our general finding will be that the member states used many opportunities to conclude cartel agreements and thus centralize the EU. In Chapter C, examples of the "cultivating the home turf strategy" will be presented. Chapter D contains four "case studies" from 2007 which show typical "raising rivals' costs" examples. Chapter E concludes the paper.

B. The Rise and Decline of Systems Competition in the EU: Some Theoretical and Historical Observations

Since the functioning of systems competition has been discussed thoroughly in other chapters of this volume, we will restrict the theoretical discussion to some specifications concerning European integration.[4] Systems competition can be (somewhat sketchily) defined as a process where political suppliers of legal rules compete for mobile factors. This process is itself governed by (meta-)rules. To put it differently: Like economic competition, systems competition requires a set of rules, a *Wettbewerbsordnung*. It has been shown that without such rules which are exogenous to the competitive process, systems competition itself cannot function properly.[5] This somewhat paradoxical notion – systems competition requires some rules which must be exempt from systems competition – bases on the proposition from constitutional theory that politicians need to be prevented from changing certain rules which they would like to change because they feel constrained in their political freedom of action. From the perspective of systems competition, it is important to note that the (meta-)rules have also to be enforced against the member states. This means that there must be a coercive power which is superior to the national state.

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4 See also Footnote 2.

5 M. E. Streit, *Systemwettbewerb im europäischen Integrationsprozess*, in D. Cassel (ed.), *Entstehung und Wettbewerb von Systemen* (Berlin, 1996) 228.

The EEC Treaty from 1957 (which later was transformed into the EC Treaty) provided such a *Wettbewerbsordnung* for systems competition.[6] The "basic liberties" of the EC Treaty, ie the constitutional guarantees for the free movement of goods, services, persons, and capital are not only the central means for opening the national markets, they are at the same time the precondition for systems competition. The liberties were supplemented by the competition rules of the Treaty. They are directed not only at economic agents (the classical antitrust rules) but also at the state (the state aid rules). Whereas the "basic liberties" safeguard the freedom of action of private agents, the competition rules constrain the room for manoeuvre both of private agents and the state. They thus define – rather abstractly – the scope of jurisdiction political suppliers in the Member States can offer to the demand side.

When interpreting the basic liberties and the competition rules as constitutive rules for systems competition, we argue somehow from a *ex-post* perspective. The legal quality of the EC Treaty described has been only fully developed by the European Court of Justice. It is impossible to sum up here the inexhaustible case law developed by the Court concerning systems competition.[7] We restrict ourselves to three important observations and the respective rulings. The Court (a) transformed the "basic liberties" from abstract obligations into subjective, enforceable individual rights.[8] The basic liberties were thus "constitutionalized".[9] The Court furthermore (b) developed the principles of the priority, the uniform validity and the direct applicability of Community law.[10] It thus allowed for the European Commission and the Court itself to enforce the *Wettbewerbsordnung* against the Member States if necessary. And together with the European Commission which introduced its "new approach" in 1985[11] the Court (c) established the mutual recognition of national product regulations as a rule in the EU and thus helped massively to remove non-tariff trade barriers within the Union.[12] When the acute discussion on systems competition started among economists in the early 1990s, most scholars concentrated on the effect the *Cassis-de-Dijon* ruling had on systems competition.[13] There is no doubt that there was an effect. But it was probably overrated by most economists.[14]

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6 See M. E. Streit, W. Mussler, *The Economic Constitution of the European Community – From "Rome" to "Maastricht"* (1995) 1 European Law Journal, 5-30; W. Mussler (note 2).

7 See eg B. Wechsler, *Der Europäische Gerichtshof in der EG-Verfassungswerdung* (Baden-Baden, 1995).

8 Case 25/62 *van Gend en Loos v Nederlandse Administratie der Belastingen* (1963) ECR.

9 E. J .Mestmäcker, *Can there be a European Law?* (1994) 2 European Review, 1-13

10 Case 6/64 *Costa v ENEL* (1964) ECR 585; Case 14/68 *Wilhelm v Bundeskartellamt* (1969) ECR 1.

11 Commission (EC), *Completing the Internal Market* (White Paper) COM (85) 310, 14 June 1985.

12 Case 8/74 *Dassonville* (1974) ECR 837; Case 120/78 *REWE v Bundesmonopolverwaltung für Branntwein ("Cassis de Dijon")* (1979) ECR 649; See also M. E. Streit, W. Mussler, *Wettbewerb der Systeme und das Binnenmarktprogramm der Europäischen Union,* in L. Gerken (ed.), *Europa zwischen Ordnungswettbewerb und Harmonisierung* (Berlin/Heidelberg 1995, 75-107).

13 See eg H. Siebert, *The Harmonization Issue in Europe: Prior Agreement or Competitive Process?,* in Idem (ed.), *The Completion of the Internal Market* (Tübingen, 1990) 53-75.

14 See T. Winkler, *Die gegenseitige Anerkennung – Achillesferse des Regulierungswettbewerbs,* in M. E. Streit and M. Wohlgemuth (eds.)*, Systemwettbewerb als Herausforderung an Theorie und Politik* (Baden-Baden, 1999) 103-121.

It has often been argued that the representatives of the founding Member states wouldn't have agreed to the content of the EEC Treaty, particularly the basic liberties and the competition rules, had they known that these rules would turn out to be conducive to systems competition and thus reduce their freedom of action and restrain the states' sovereignty. Ernst-Joachim Mestmäcker's assertion that the Member States agreed to the Treaty behind a Rawlsian "veil of ignorance"[15] suggests that they were probably not willing to accept unresistingly the post-constitutional results once the veil would be lifted.

It is thus hardly surprising that the member states tried to change the rules of the game in the post-constitutional phase in order to resume some discretionary power. The Treaty has been re-negotiated and modified several times since 1957, by the Single European Act (1987), the Treaties of Maastricht (1992), Amsterdam (1997), Nice (2000) and Lisbon (2007). The general result of all these re-negotiations was the introduction of new regulation and intervention competences on the EU level. To put it differently: The rules thus added to the Treaty were rather conducive to centralization and re-regulation and tended to reduce systems competition.[16] The Member States were partially supported by the Community institutions like the Commission and the Court as far as these were also interested in more centralization and regulation.

The centralization and re-regulation hypothesis can be substantiated by political economy of centralization.[17] It is based upon the general assumption from public choice theory that politicians (as well as bureaucrats and judges) are self-interested agents who aim at maximizing their own power, influence, and budget. It is thus not very difficult to explain why the Commission and the Court were always in favour of further centralization. They invariably agreed to assume additional competences when possible, irrespective of whether these competences were necessary to enforce systems competition or whether they just established some new intervention power on the EU level.

It is more difficult to explain that centralization was also in the interest of the member states: It seems to be, at first sight, a zero-sum game, taking competences from the national state to the EU level. From a systems competition perspective, however, the member states' support may become somewhat more comprehensible. The member states couldn't avoid the economic impact of the Court rulings on systems competition, nor could they change directly the legal rules on which the rulings were based. Since those rulings reduced the discretionary power of the member states on the national level (and frequently prohibited them from intervening into the market process on the national level), it seemed to be a logical reaction to regain the discretionary power on the European level – by introducing new EU policies like R&D, environment, cohesion, consumer, social, and industrial policies. It is important to note that centralization doesn't necessarily mean a loss of power for the member states. They also decide on EU level: Apart from some few exceptions, no political decision can be taken without the consent of the Council, the representation of the member states. Additionally, it is a big advantage for national politicians that they can blame "Brussels" for a decision which has been taken

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15 E. J. Mestmäcker, *Auf dem Wege zu einer Ordnungspolitik für Europa,* in Idem (ed.) *Eine Ordnungspolitik für Europa* (Baden-Baden, 1987) 9-49.

16 See more extensively W. Mussler, *Die Wirtschaftsverfassung der Europäischen Gemeinschaft im Wandel* (Baden-Baden, 1998) 125.

17 See eg R. Vaubel, *The Political Economy of Centralization and the European Community,* (1994) 81 Public Choice, 151-190.

in the Council (under possibly obscure circumstances) – even if they agreed to the decision themselves.

In a way, increased regulation possibilities on the EU level thus served as a substitute for restricted regulation possibilities on the national level. However, the above summary may have exaggerated the effects of systems competition in Europe as well as the attempts to restrict it. Firstly, EU law was, despite its enforcement by the Court, never completely able to prevent national government from interfering with private cross-border action. Secondly, and contrary to the first argument, under the conditions of globalization every government is always exposed to some competitive pressure. When making this argument, we do not deny the crucial importance of institutions or legal rules for systems competition. We only want to stress that the "unevitableness of competition" (*Vanberg*) holds true also for systems competition.[18] Thirdly, even if they may be already much too comprehensive by economic measures, the new EU policies are still rather unimportant compared to what the member states expend on them. This won't change as long as the EU won't be enabled to raise own taxes. And finally, it must be kept in mind that the above analysis in terms of systems competition in a somewhat synthetic one: No founding father of the European Treaties and no European judge who interpreted the Treaties ever had in mind that the rules or their enforcement could be interpreted later as conducive to systems competition. The Court "simply" enforced the legal validity of the internal market, i.e. provided for the removal of trade barriers.

What does this outline imply for the general probability of success of the three strategies presented in Chapter A, ie "cultivating the home turf", "increasing competitors' costs" and "reducing competition by cartelization"? A (quite general) hypothesis which is to be checked in the following chapters could be as follows: The "inevitability of competition" and the presence of respective rules in the EU seem to imply that systems competition is the standard case in Europe, even without member states actively cultivating the turf. The mere fact that national rules differ from each other, that the national systems are open and that mobile factors tend to migrate from State A to State B creates systems competition. The general reaction of member states is rather to restrict this kind of competition than enhancing it by creating new competition strategies. When trying to "test" this hypothesis in the following chapters, we will be forced to only present some anecdotic examples of each strategy. Since the presentations will be far from complete in each case, it will also be difficult to conclude which of the strategies prevails. However, the author can tell that he didn't have too many problems to find some illustrative examples for member states increasing competitors' costs. We also implicitly discussed already some of the member states' cartelization strategies in this chapter. It was more difficult to identify illustrative "cultivating the home turf" examples.

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[18] V. Vanberg, *Ordnungspolitik und die Unvermeidbarkeit des Wettbewerbs*, in H.-H. Francke (ed.), *Ökonomischer Individualismus und freiheitliche Verfassung* (Freiburg, 1995) 187-211. See also M. E. Streit, *Dimensionen des Wettbewerbs – Systemwandel aus ordnungsökonomischer Sicht*, (1995) 44 Zeitschrift für Wirtschaftspolitik, 113-134.

C. Cultivating the Home Turf – or Simply Safeguarding National Sovereignty: Where Systems Competition Works

I. Tax Policy

1. Introductory Remark

Tax policy has not only been the traditional starting point of any theoretical discussion about systems competition,[19] it is also regarded as the classical empirical case for systems competition in the EU.[20] We cannot discuss here the pros and cons of tax competition generally, nor can we elaborate on all the different kinds of tax competition to be found in the EU. We will confine ourselves to the following observations: (1) In the first decades of European integration, many politicians as well as many scholars called for a harmonization of national tax parameters such as rates, but also tax bases. They argued that in an internal market tax conditions must be uniform in order to ensure a "level playing field" and to avoid a "race to the bottom". They didn't want to accept that, for example, tax rates can also be used by the member states as a competitive parameter. (2) Not only these (more or less) objective arguments in favour of harmonization, but also the political economy of centralization suggests that tax rates and other tax parameters tend to be harmonized. There is ample empirical evidence that tax competition is at work and effectively erodes the national tax bases. There should be thus enough incentives for national politicians to restrict tax competition. (3) However, even if there have been a lot of political harmonization attempts, tax policy is still (almost exclusively) a national issue.

2. Direct Taxation

Since capital is the most mobile factor, it is not surprising that those taxes which depend mostly on capital movements were considerably reduced in the last years. The average corporate tax rate in the EU declined from 38 % in 1993 to 24.2 % in 2007.[21] However, there was still a large difference of rates within the EU last year: They varied between 38.36 % in Germany (even if the German rates dropped by approximately 20 percentage points in the last 20 years) and 10 % in Bulgaria and Cyprus. Both the considerable decline of the rates and the considerable differences between the member states suggest that corporate tax competition is well at work in the EU. It was already animated after the transformation of the formerly socialist economies in Middle and Eastern Europe. And it was further stimulated when those countries got a concrete perspective to enter the EU and, finally, joined it in 2004. It is primarily thanks to those countries that

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19 C. M. Tiebout, *A Pure Theory of Local Expenditures* (1956) 64 Journal of Political Economy, 416-424.

20 See already H.-W. Sinn, *Tax Harmonization and Tax Competition in Europe* (1990) 34 European Economic Review, 489-504; for more recent overviews see C. Fuest, B. Huber, J. Mintz, *Capital Mobility and Tax Competition: A Survey* (2005) 1 Foundations and Trends in Microeconomics 1-62; S. Ganghof, P. Genschel, *Taxation and democracy in the EU* (2007) MPIfG Discussion Paper No. 07/2.

21 KMPG's Corporate and Indirect Tax Rate Survey 2007, http://www.in.kpmg.com/pdf/CorpTaxRateSurvey2007.pdf, 9.

systems competition has considerably intensified in the last years, and it is also there where concrete examples of "cultivating the home turf" can be found. The Baltic states, but also countries like Slovakia, Bulgaria and Romania attracted foreign investors not only by levying low rates, but also by offering very simple tax systems. Several countries introduced a so called flat-rate tax or consider to do so. In Slovakia, a flat rate of 19 % is equally effective for corporate tax, income tax, and VAT.

Even if many finance ministers of "old" EU member states often deplore the increased tax competition, none of them openly makes any attempt to harmonize the rates on the EU level. The last "achievement" towards harmonization was the Code of Conduct for Business Taxation adopted by the Council in 1997 which aimed at confining so-called unfair practices in business taxation. A working group chaired by British Paymaster General Dawn Primarolo identified quite a couple of such practices and still continues its work.[22] It is sometimes argued that the ban on such practices can be interpreted as an attempt to restrict tax competition. The alternative interpretation is that such a ban is nothing more than a concretization of rules on systems competition, ie a part of a *Wettbewerbsordnung* for tax competition. Which interpretation is correct can probably only be answered from case to case.

At the moment, not even minimum rates are discussed since they don't seem to be politically achievable. However, the Commission got a mandate by the ministers in 2004 to elaborate a concept for a so called Common Consolidated Corporate Tax Base (CCCTB). The advocates of such a harmonization of the tax base argue that it reduces transaction costs for business by removing distortions of competition caused by differences between national tax bases. The Commission is currently working on the technical details of such a CCCTB. However, it is more than questionable if it will ever decide on a concrete proposal. Officially, the Commission still sticks to the objective to start the CCCTB in 2011. But there are not only several commissioners, but primarily several member states which do not agree with the general idea of harmonizing the corporate tax base. This holds true particularly for those states with specific tax rules which they don't want to give up (like Ireland), but also for some new member states with low rates who suspect that CCCTB would be just the first step on the way towards encompassing harmonization, including rates. Since the CCCTB project is very unpopular in Ireland, the Commission decided in January 2008 not to promote it any further before the Irish referendum on the Lisbon Treaty in summer 2008.

Generally, direct taxation is thus a domain of systems competition. This observation is also supported by the fact that income tax rates differ also quite considerably between member states. They didn't decline in the last years, though, which is in line with the theoretical suggestion that tax competition is less intensive when it concerns less mobile factors. Even with tax competition at work, however, the European Commission couldn't find any empirical evidence for the "race to the bottom" hypothesis: Tax revenue maintained a stable share of about 38 % of GDP over the last years in the EU average.[23]

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[22] Report from Code of Conduct Group (Business Taxation) to Ecofin Council on 29 November 1999, http://ec.europa.eu/taxation_customs/resources/documents/primarolo_en.pdf.

[23] European Commission: Taxation Trends in the European Union – Main Results, http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_structures/Structures2007_main_results.pdf, May 2006.

3. Indirect Taxation

When it comes to indirect taxation, the general picture is quite similar, even if there are some differences to direct taxation. Originally, the Commission followed the idea that the completion of the Internal Market required a harmonization of the national VAT systems in order to avoid distortions of competition in cross-border transactions. Nowadays, the EU is still far from such a harmonized system, and there are considerable doubts (1) whether harmonization is necessary and (2) whether substantial steps towards more harmonization will follow in due time. The vast variety of national VAT rules already suggests that every member state is cultivating its home turf. In a way, however, VAT is a field where all three strategies – cultivating the home turf, raising rivals' costs, and reducing competition – are combined. The reason is the special VAT rate regime in the EU. The member states agreed on a harmonized minimum rate of 15 %; insofar tax competition is attenuated. Beyond this, however, rates differ between 15 and 25 %, insofar tax competition is at work. For a couple of member states, relatively high VAT rates serve as a substitute for lower corporate tax rates – and in that, they serve also as parameters for government cultivating the home turf in tax competition. Finally, raising rivals' costs plays quite an important role since the EU's VAT system allows for many exceptions to the minimum rate. These have to be approved individually by the Council. As a consequence, many member states try to obtain new exceptions for special purposes for themselves. For example, France has been trying for a long time already to get reduced VAT tax rates for the hotel and restaurant industry. Other member states were successful two years ago in obtaining reduced rates for handicraft enterprises and hairdressers. When trying to get an exception from the general cartel rule, member states do not only want to grant privileges to domestic business, they also try to raise the (relative) costs of their competitors.[24] Such exceptions can, however, just be interpreted as additional evidence for the fact that tax policy resists obviously most harmonization attempts.[25]

II. Civil Law

Given the range of academic work done in this field, one could possibly make a good a case for the harmonization of national civil codes in Europe. Such a harmonization could possibly reduce transaction costs for business and would thus contribute to a "real" completion of the internal market like, eg, tax harmonization. In December 2007, the "Joint Network on European Private Law", an association of European legal scholars, has delivered to the European Commission the Draft Common Frame of Reference (DCFR) prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law,[26] The European Commission, which is principally sympathetic to this project, promised meanwhile to review the Draft carefully and to consider whether it could help to promote any legislative proposal aiming at harmonizing European civil law. The next step towards such a proposal could be a White Paper. The Commission indicated

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24 See W. Mussler, *Das europäische Mehrwertsteuerkartell,* Frankfurter Allgemeine Zeitung (Frankfurt 9 February 2006) 11.

25 See generally P. Genschel, *Steuerwettbewerb und Steuerharmonisierung in der Europäischen Union* (Frankfurt, 2002).

26 See http://www.sgecc.net, 2 January 2008.

already informally, however, that if there was any chance to pursue the project further, the Draft would have to be abbreviated considerably.[27] However, even if the idea of a European Civil Code is heavily backed by European Parliament, it seems extremely improbable that the Commission will ever present a legislative proposal. The reason is simple: There is no support at all from the member states. They deny the EU to be competent for civil law and want to maintain "their" national civil law rules maybe even because those can be interpreted as an advantage of location in systems competition. Moreover, they refer to the mere political impossibility of amalgamating completely different legal traditions, eg the Anglo-Saxon and the Continental one. According to a diplomat affiliated to the German Representation to the EU, the whole DCFR project is "merely an academic exercise" and will never be seriously discussed in Council.[28]

III. Explanations

Tax policy and civil law are, in principle, policy fields where member states could profit from cartelization on EU level. Harmonization of tax policies could (possibly) raise national tax income, and when a common civil law code could (possibly) reduce transaction costs for business, this should also be in the interest of national governments (at least if harmonization induces no other costs for them). Why do we still observe only very little bias towards harmonization on these fields? In tax policy, a superficial explanation is the rule that the Council has to take every decision on tax issues unanimously. This rule implies that tax cartels can emerge only if really all member states agree on a cartel agreement or if at least those who don't agree can be compensated by a trade-off. However, the unanimity rule is only an indication for the fear of the member states' representatives of being overruled in the Council – if they wanted, they could change it. Insofar, the unanimity rule is only an indirect explanation for the persistence of tax competition.

A more general, and more plausible, explanation is that there are certain policy fields which constitute somehow national sovereignty. Taxing power is among them, and so is legislation on civil (and of course constitutional) law. If the member states transferred some legislative power in these fields to the EU, they would have to expect to effectively lose regulatory power – even if they might profit from the transfer of competences at short notice. The famous judgment of Chief justice John Marshall of 1819 that "the power to tax involves the power to destroy"[29] is still true today, even if only metaphorically.

D. Increasing Competitors' Costs: Four Recent Examples

I. Introductory Remark

In this chapter, we will discuss four recent cases (dating by and large from 2007) where member states clearly applied increasing competitors' costs strategies. It must be admitted, however, that these cases are not completely isomorphic: Member states can influ-

[27] Anonymous source, European Commission.

[28] Information given to the author, 25 March 2008.

[29] *McCulloch v Maryland* 17 US 316 4 L Ed 579 (1819).

ence the political decision process in the EU at different stages, not only when a legislative project is discussed in Council, but also even before the Commission launches such a proposal. And obviously a considerable part of the political bargaining process on the EU level takes places in secrecy, which means that it cannot always really be described adequately. In some of the cases to follow, we rather specify the political conflicts (and thus the competitors' costs at stake) than the exact political strategies – for the simple reason that they are not fully known (yet).

II. Fighting Global Warming

In March 2007, the European Council agreed on the "triple 20 % objective" in climate protection policy: By the year 2020, the EU aims at reducing energy consumption by 20 %, at reducing greenhouse gas emission by 20 %, and at increasing the share of renewable energy in total energy consumption by 20 %.[30] The main political motive of the then German EU presidency to promote this agreement was the upcoming G 8 summit also presided by Germany in June 2007 where Chancellor Angela Merkel wanted to present herself as the leading political figure in the fight against global warming. It was up to the Commission, however, to transform the political declaration made by the Council into concrete legislative proposals. It did so, meanwhile, by presenting (a) a proposal for a directive on the reduction of car emissions[31] in December 2007 and (b) the "climate package" in January 2008.[32] In both cases, the overall consensus of the member states about the objective of reducing greenhouse gases was rapidly shattered when it came to share the burden resulting from this objective.

In the case of car emissions, it became clear quite soon that the European fight against climate change would turn into an intra-EU fight between the most important car-producing countries. The Commission had to answer two questions: (1) How much carbon dioxide can a car be allowed to emit on average in the future to meet the general climate protection objective? (2) Which is the adequate burden sharing, ie how much more emissions can big cars be allowed in comparison to small ones? The first question had been answered by the Commission already in February 2007 when it fixed the average emission at 130 grams per kilometre. The second question was discussed extremely controversially among the member states, especially by Germany on the one hand, and France and Italy on the other. The reason for this line of debate is the fact that German car manufacturers predominantly produce big and heavy cars, whereas French and Italian cars are (on average) smaller and lighter. Merkel on the one hand, President Nicolas Sarkozy and Prime Minister Romano Prodi on the other, heavily lobbied in Brussels prior to the presentation of the Commission proposal in order to affect the "slope line" (ie the formula by which the Commission determined the burden sharing) in favour of their domestic industries.

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30 Brussels European Council, 8/9 March 2007, Presidency Conclusions, 7224/1/07 REV 1, http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/93135.pdf.

31 Commission (EC), *Revised Proposal for a Directive of the European Parliament and of the Council on the promotion of clean and energy efficient road transport vehicles*, COM (2007) 817 final, 19 December 2007

32 Commission (EC), *Proposal for a Decision of the European Parliament and of the Council on the effort of Member States to reduce their greenhouse gas emissions to meet the Community's gas emission reduction commitments up to 2020*, COM (2008) 30 final 23 January 2008.

The intra-EU dispute was (and is) highly delicate for Commission president José Manuel Barroso who strives for a second term in office in 2009, for which he needs the consent of as many member states as possible.

The Commission proposal which consists of a compromise between the two positions (and a lot of complicated technical details which cannot be described here) was, as expected, criticized by both sides. All car-producing member states didn't remember their self-commitment to climate protection policy and instead blamed the Commission for pursuing industrial policy at the expense of their car manufacturers. Chancellor Merkel attacked the Commission for planning fines much too high for those manufacturers who don't meet the emission limits, and Sigmar Gabriel, German Minister for the Environment, blamed the Brussels authority for instigating a "competitive war between the German, the French and Italian car industry".[33] At the same time, a lot of German politicians tried to generally put the blame of the carbon dioxide reduction plans on "Brussels" – even if those plans clearly were the result of a Council decision taken under the German presidency. When this volume was published, the destiny of the Commission proposal was still uncertain. It can be expected that it will be subject of a typical bargaining process in the Council. The most probable result of this process will be a partial withdrawal of the overall emissions reduction objective, which allows for alleviation decisions for the benefit of industries in Germany as well as in France and Italy.

In the case of the "climate package", similar intra-EU conflicts emerged. For example, the Commission factored out the question if energy-intensive sectors like steel and paper industries can expect some exception from the general climate protection legislation which consists, among others, of extensive emissions trading schemes. Several member states argue that these industries have to be exempted from the general rules because they would suffer a considerable competitive disadvantage otherwise. What became clear when the Commission presented the package, however, was that certain member states had been more successful than others in promoting their political objectives in Brussels. Quite surprisingly, eg, the Commission had changed the reference year for the single emissions reduction objectives for every country from 1990 to 2005. This implied a gratification for all those countries which had little contributed to the Kyoto objectives in the last years, especially Spain and Greece. Countries like Germany and the United Kingdom, which reduced their emissions quite considerably in the last years, claim that the package leads to an unjust burden sharing. A similar problem concerning the reference year arises when it comes to increasing the share of green electricity. The Commission wants to oblige every country to rise that share by more or less the same percentage, irrespective of how many green electricity is already being produced in a certain member states. This provision discriminates, eg, Austria which traditionally produces a high share of its electricity in hydroelectric power stations. Finally, France was quite successful, too: Due to the pressure of the French government, the Commission suggested to classify nuclear power as a climate friendly technology which can be credited against the specifications on increasing green electricity. This is a considerable advantage for France where a high share of electricity is produced in nuclear power stations. Like the car emissions proposal, the final shape of the "climate package" was still to be discussed in Council when this article was finished.

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[33] *Brüsseler Plan schockt Autobranche*, Handelsblatt (Düsseldorf 20 December 2007) 1.

III. Ownership Unbundling in the Energy Sector

The European Commission has been addressing the lack of competition on the European energy markets for quite a long time, and by different means. The official opening of the national markets in July 2007 obviously didn't overcome the multiple competition problems which result from the oligopolistic market structures in the sector.[34] This observation was substantiated by the results of the energy sector inquiry published by the Commission in January 2007.[35] Whereas the inquiry results themselves weren't disputed much, the political consequences were discussed highly controversially within the EU. President Barroso as well as Commissioners Neelie Kroes and Andris Piebalgs argued that the current lack of competition can only be overcome by an overall ownership unbundling solution. In its "energy package" of September 2007,[36] the Commission proposed full ownership unbundling as its priority solution. As an alternative, it suggested to transfer all functions of power grid to an independent system operator (ISO). This second solution can be interpreted as a kind of "soft" ownership unbundling.

The ownership unbundling regulation would primarily affect member states like Germany, France, and Austria where markets are not only dominated (or divided up) by few oligopolists, but where the energy suppliers are also vertically integrated, ie producers own also the grid. In member states like the United Kingdom and the Netherlands, however, ownership unbundling has been enforced already on the national level. For British and Dutch suppliers, the Commission proposal would thus change much less than for German or French quasi-monopolists. The latter would clearly have to expect some competitive disadvantages. It didn't come as a surprise, hence, that many German and French politicians, members of national government as well as of European Parliament, blamed the Commission for having followed a "British" approach when launching its proposal. Their core argument, even if not expressed openly, which can be neither proven nor disproven here, was that the British government influenced the Commission heavily prior to the presentation of the package, and that the supporters of ownership unbundling profited additionally from the fact that Commissioner Kroes is Dutch.

Such arguments may basically trace back to implausible conspiracy theories. However, it is quite obvious that the debate about ownership unbundling touches massively upon the interests of nearly every member state. Most of the strategies adopted by the member states in Council are thus also aimed at increasing competitors' costs. When the discussion of the package in Council started in December 2007, about half of the member states seemed to support the Commission's position. Germany, France and six other states presented an alternative proposal which they call a "third way". It would result in a legal separation of production and grid. However, a vertically integrated supplier wouldn't be forced to sell his grid. It would only be obliged to separate production and grid more distinctly than before. The Council hasn't taken a decision about the Energy Package yet when the manuscript of this paper was finished. In terms of systems competition, this

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34 See generally, eg, Monopolkommission, *Strom und Gas 2007: Wettbewerbsdefizite und zögerliche Regulierung* (Sondergutachten No. 49, Baden-Baden 2008).

35 Commission (EC), *Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors*, (Communication) COM (2006) 851 final, 10 January 2007.

36 Commission (EC), *Proposal for a Regulation of the European Parliament and of the Council establishing an Agency for the Cooperation of Energy Regulators*, COM (2007) 530, 19 September 2007, see also the proposals COM (2007) 528, 529, 531, 532.

case is extremely complicated because the calculus of the member states trying to raise competitors' costs is not only determined by the usual considerations in locational competition, ie how to privilege the national industry. Quite a couple of the national energy suppliers are still (partly) state-owned. All those national politicians who are somewhat involved in such public enterprises have to protect also their own interests when trying to keep away (economic) competition from national enterprises.

IV. Financing of and Procurement Procedures for Galileo

The European Satellite Navigation System Galileo had originally been planned as a public-private partnership (PPP) project. When it proposed Galileo the first time in 1999, the Commission claimed that the project could be financed by low interest loans by, eg, the European Investment Bank and that the private sector had to bear the risk if the costs exceeded the given fiscal planning. The original plan thus was that Galileo should go without taxpayers' money. Given the dimension of the project, only a couple of (normally big) European aerospace companies are in a position to execute the contracts in question, and they are concentrated in France, Germany, and Italy. Those three member states had thus the greatest interest in the project from the beginning, as well as the Commission did. Even if every "package" of the project was to be tendered, the competitive effect of such tenders seemed to be limited since, for technical reasons, only few suppliers are able to meet the criteria asked for in the tender procedure. Therefore, the original setting of the project rather seemed to set the stage for a cartel of the three member states and the Commission which could have split the contracts for Galileo among the different companies without much public noise.

However, the companies involved didn't play along. Transport Commissioner Jacques Barrot announced in May 2007 that the long-lasting negotiations with business on PPP had failed since the companies weren't willing to bear the foreseeable additional costs. For this reason, Barrot suggested that the Commission should assume the general responsibility for the project and become especially responsible for the procurement of the infrastructure for Galileo.[37] This, however, would require additional public money for the EU budget of (in the first instance) 3.4 billion €.

Even if all three member states still massively supported the project, this turn put them quite into a quandary. Firstly, it seemed obvious why business refused to take any additional risk: Cost explosion would probably continue and nobody could assure that the public money needed could be limited to 3.4 billion €. Secondly, it was politically difficult to allocate additional public money to Galileo. 2007 was the first year of the new EU financial framework 2007-2013 which had been agreed upon in 2005. This framework is quite unequivocal in terms of the volume of the EU budget of each year as well as in terms of its structure. It was practically impossible to shift any positions within the budget. For Galileo, it provided one billion. And thirdly, it would have been practically impossible for the three member states to get extra money to the EU assigned for this project already in the first year of a new financial framework – because this would have hardly been justifiable towards the public, but also because those member states not involved in Galileo would not have agreed. Several member states, especially Germany as the main

[37] Commission (EC), *Galileo at a cross-road: the implementation of the European GNSS programmes*, (Communication) COM (2007) 261 final, 16 May 2007.

net contributor to the EU budget, therefore rejected Barrot's plan publicly and announced that they wouldn't agree on spending additional public money. Some German politicians who not necessarily represented the position of the German government qualified this argument by claiming that the volume of the contracts for German industry would have to be at least as high as the German financing share.

Barrot had the interests of the member states well in mind when he presented his final proposal in September 2007.[38] He suggested to obtain the rest of the money by shifts within the budget, especially by reducing expenses for agricultural policy and administration. Additionally, the Commission proposed a completely new call for tenders for all parts of the project, thus implicitly nullifying all tacit agreements on contracts which had already been made in a cartel-like way in the years before. Barrot's argument seemed completely respectable: When doing away with every old agreement and introducing more competitive elements into the procedure, the Commission should be able to reduce the costs of the project. At that time, the industry asked already for 4.5 billion €.

The German government sticked to its policy of completely rejecting any Galileo financing from the EU budget, on the one hand, and of criticizing Barrot's tender proposal, on the other. The German administration was afraid that if all lots were tendered this would "privilege" French enterprises. Therefore it demanded German industry to be guaranteed a given percentage of the contracts. Germany never explicitly gave up its refusal to finance Galileo with EU money, but indicated rather unambiguously that it wouldn't resist such a solution as long as German industry would get "compensated" for this. This is quite a typical example for increasing competitors' costs by bargaining in Council.

The interests of the parties which negotiated about Galileo in November 2007 can be sketched as follows: German government had a massive interest in Galileo, wanted to get a (guaranteed) share for its industry, but didn't want to be identified again as the paymaster (in the role of net contributor to the EU budget). French government had an even more vivid interest in Galileo and didn't really care about the procurement procedures. It supported the financing from the EU budget. Barrot, representing the Commission, was also heavily interested in Galileo, he wanted as much EU money as possible for it (which he couldn't say publicly), and he pretended to favour the tender procedures. However, what counted much more for him was that the Commission would (re-)gain control on the whole infrastructure project. Whether the contracts would be obtained by tender or by agreement wasn't decisive for the Commission.

The agreement found in Council corresponds to these interests. The project will be fully financed from the EU budget. Nominally, the financing will essentially be permitted by shifts within the budget: 1.6 billion € will be taken from agricultural policy, the rest from several other budgetary items. However, the 1.6 billion € is money which has not been spent in 2007, primarily due to the rise of farming prices. It would normally have been given back to member states. Even if German government can claim that it doesn't have to pay any additional money to the EU for the moment, it gets back considerably less than without Galileo. As to the procurement procedures, a tender procedure is envisaged; but the companies are encouraged to tender as a consortium. Moreover, the Council agreed to divide the project into six contract packages. No company gets access to more than two of these packages. According to German diplomats, this rule guarantees German enterprises a "fair share" in Galileo.

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[38] Commission (EC), *Progressing Galileo: Re-Profiling the European GNSS programmes*, (Communication) COM (2007) 534 final, 19 September 2007.

V. The Shaping of EU Antidumping Rules

Antidumping policy is not only an instrument the EU uses extensively in global systems competition, ie to prevent competition from the European market. It is also a means of intra-EU systems competition because member states are affected by antidumping rules very differently. Generally, the more they import the less they are interested in antidumping measures – and reciprocally, those member states are mostly interested in antidumping whose industries are producing goods which they wish to be protected against "dumped" goods from abroad. Since antidumping policy is very sector-specific, some countries can be interested in particular antidumping measures and completely uninterested in others. Additionally, interests of the member states can be determined by the fact in how far their home industry has relocated production to "dumping" countries and is thus affected by antidumping measures itself. A typical example for such an intra-EU conflict was the question emerging in 2007 if the EU antidumping tariff on electric bulbs should be maintained or not. It could clearly be traced back to a conflict between the two big producers Osram (which still mainly produces in Europe) and Philips (which produces primarily in China). The conflict was solved at the expense of Philips: The tariff was maintained.

Since EU antidumping policy is decided by the Council, member states can use it as an instrument of increasing (primarily extra-EU, but also intra-EU) competitors' costs. Since the EU opens a considerable number of new procedures every year (187 in 2006), the member states' strategies vary from case to case. Generally, the countries from southern and eastern Europe tend to give a more favourable opinion on antidumping measures than the northern countries. However, this is only generally true. Especially Germany changes fronts regularly, depending on which industry is at stake. In the electric bulb example mentioned above, Germany was on the protectionist side, in other cases like decisions concerning tariffs on shoes or on air conditioning compressors it voted (without success) against the tariff.

For obvious reasons, the current antidumping rules allow for a considerable amount of member states' discretion in the Council and thus for increasing competitors' costs strategies. Not least for this reason, Trade Commissioner Peter Mandelson announced in November 2007 to launch a reform proposal soon. He wanted to redefine the facts meeting the criteria of dumping in a tighter way in order to reduce the Council's scope for antidumping measures. With the exception of Great Britain, Ireland, the Netherlands and the Scandinavian states, all member states protested against this plan. Interestingly enough, also Germany with its traditionally export-oriented industry insisted on a wide range of antidumping measures and blamed Mandelson of "pursuing the interests of the British industry". It didn't matter that German industry would probably be generally better off if the scope of antidumping policy were reduced and that consumers profited from such a reduction, too: The German government (together with the national top associations of industry) heavily lobbied against the Mandelson plan. It clearly counted more for the German administration (as well as for most of the other member states) to obtain considerable discretionary power in Council for single antidumping measures than to improve the general situation of the consumers. The popularity of discretionary measures seems to indicate that the member states don't want to deprive themselves of the general power to raise competitors' costs. Being confronted with the broad resistance by the member states, Mandelson abandoned his reform plan in January 2008.

E. Conclusion

In order to complete our "case framework", we ought to add a chapter on cartel agreements of the member states here. This would, however, not only go beyond the scope of this paper. It would also be, in a way, quite redundant. We already saw in chapter B that the EU history was characterized by several (quite successful) attempts to centralize and cartelize EU policies. There is ample evidence that the member states tried to restrict systems competition on the constitutional level. This tendency can be observed also in daily political business. All examples from chapter D, which should serve as evidence for the raising rivals' costs strategy, incorporate also elements of collusive behaviour. It can be guessed that the normal strategy of a member state in Council is thus a mixture of competing and colluding. Generally, member states like using EU policies as an instrument to conceal accountability. This strategy does not apply, however, if they have to worry that an EU policy would substantially reduce national sovereignty, like it is the case with a harmonization of, eg, tax policies. As far as we can learn from the cases presented above, the driving forces of intra-EU systems competition are twofold: Firstly, the representatives of the member states obey the traditional incentives and restrictions of (primarily national) political competition. They have to consider the interests of (again: primarily national) pressure groups and to worry about their (national) re-election. Secondly, they are subject to the pressure which results from economic competition (described above as the "inevitability of competition"). More generally, member states act between the constraints of systems competition and the temptations of cartelization. The constraints are characterized by Nobel Prize winner Douglass North as follows:

"The state is constrained by the opportunity cost of its constituents since there always exist potential rivals to provide the same set of services. The rivals are other states, as well as individuals within the existing political-economic unit who are potential rulers. The degree of monopoly power of the ruler, therefore, is a function of the closeness of substitutes for the various groups of the constituents."[39]

The temptations are characterized, if only in one dimension, by Brennan and Buchanan:

"The potentiality for collusion among separate units varies inversely with the number of units. If there are only a small number of nominally competitive governments, collusion among them (…) may be easy to organize and to enforce."[40]

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[39] D. C. North, *Structure and Change in Economic History* (Norton, New York 1981, 23).

[40] G. Brennan, J. M. Buchanan, *The Power to Tax* (Cambridge University Press, Cambridge 1980, 180).

Competition in and from the Harmonization of Private International Law

Ronald A. Brand[*]

[I]t should be noted that the European Community is engaged not only with regulating commerce between Member States but also in competing with the rest of the world. If the Member States of the European Community are unable to offer a seat of arbitration capable of making orders restraining parties from acting in breach of the arbitration agreement, there is no shortage of other states which will. For example, New York, Bermuda and Singapore are also leading centres of arbitration and each of them exercises the jurisdiction which is challenged in this appeal. There seems to me to be no doctrinal necessity or practical advantage which requires the European Community handicap itself by denying its courts the right to exercise the same jurisdiction.[1]

Throughout the development of the single market the theme has been that competition is a good thing which will improve the market, and as long as there is recognition of each other's acts and institutions, the market will evolve properly. But in legal services the philosophy is different: divergence in jurisdiction (and increasingly in choice of law) is not thought to improve the single market, but to do damage [to] it.[2]

A. Introduction

The two quotes set forth above demonstrate that both judges and scholars realize that competition plays a role in the development of legal systems. The issue of competition in private international law is one that has received significant recent attention, but without generating common analysis.[3] An economic model for analysis of competition in private international law seems not to have developed to the point of agreement on the effect of

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[1] West Tankers Inc v Ras Riunione Adriatica di Sicurta SpA, 1 Lloyd's Rep 391, [2007] 1 All ER (Comm) 794, at & 23.

[2] Adrian Briggs, *The Impact of Recent Judgments of the European Court on English Procedural Law and Practice*, Zeitschrift für Schweizerisches Recht 124 (2005) II 231-262 University of Oxford Faculty of Law Legal Studies Research Paper Series, Working Paper No 11/2006, April 2006, 22 http://papers.ssrn.com.

[3] *See, eg*, Emanuela Carbonara and Francesco Parisi, *Choice of Law and Legal Evolution: Rethinking the Market for Legal Rules* http://ssrn.com/abstract=10-11376; Ugo Mattei and Francesco Pulitina, *A competitive model of legal rules*, in *The Competitive State: Villa Colombella Papers*

a domestic legal system on the marketplace for legal rules. Whether economic analysis can explain all elements of such competition is neither settled nor entirely clear.

In this paper I do not presume to generate the decisive analytical framework for assessing competition among private international law legal systems. I choose instead to begin with the assumption that where there is difference there is comparison, and where there is comparison there is competition. Though this assumption may seem rather intuitive, the further definition of just how private international law systems compete is not always clear; and the intersection of law and economics demonstrates that some types of possible competition may fall outside the boundaries of traditional economic analysis.

Recent developments in private international law demonstrate two principal types of competition between and among legal systems. The first may be expressed as competition *in* the harmonization of private international law, and the second as competition *from* the harmonization of private international law.

Competition *in* the harmonization of private international law occurs between and among states, with each vying to have its model of legal rules adopted on a more global basis. This type of competition plays out both in the negotiation of federal and multilateral instruments and in the development of domestic legal rules of states that look to examples from other states. There is a second – and subsidiary – aspect to this competition. Thus, one may find competition between a focus on party autonomy (in support of the interests of the private party in transnational legal relationships) and a focus on state-centric "mandatory rules" of private law (protecting perceived state interests from erosion through too much deference to party autonomy). It is this element that most directly affects the level of attention given to the interests of private parties whose conduct will be governed by the rules in question.

Competition *from* the harmonization of private international law occurs when some aspect of legal systems may be harmonized, but other aspects remain different. This is the level at which private parties may select among the various legal systems available in a market place of legal rules. So long as there is recognition of party autonomy, private parties, through choice of law and choice of forum, will cause states to compete for the "business" of private parties who are able to choose the legal systems to govern their relationships.

The negotiations leading to the 2005 Hague Convention on Choice of Court Agreements provide a case study for the demonstration of both competition *in* the harmonization of private law and competition *from* the harmonization of private law. Competition between and among legal systems was demonstrated during the Convention negotiations both in the evolution and assertion of European Community competence in the realm of private international law, as well as in negotiations in The Hague on a global level. Developments in the European Union that occurred in parallel with the Hague Negotiations provide a clear example of both competition to select from alternative legal rules within an evolving multi-state (or federal) system, as well as external competition to assert legal rules on a more global scale. The Hague negotiations, as well as the rules in the Convention itself, also provide a context for consideration of the subsidiary competition between party autonomy and public values that affect directly the application of private law rules to private parties.

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on Competitive Politics (1991) (Albert Breton, Gianluigi Galeotti, Pierre Salmon and Ronald Wintrobe (eds.) 1991).

The Hague Convention, and the negotiations leading up to it, provide a useful case study for discussing legal system competition for both sovereign selection in the multilateral harmonization of the rules of private law and private international law and private party selection of rules to govern transnational private relationships. It is hoped that the discussion below will facilitate further consideration of how states might best participate in such competition and how we might all benefit from (or be harmed by?) such competition on a global basis. This discussion will also consider how the Hague Convention on Choice of Court Agreements demonstrates potential for competition among legal systems through choices available to private parties. By offering a regime that will honor party choice in the selection of judicial forums for dispute settlement, and provide rules compelling the enforcement of the resulting judgments, the Convention sets the stage for competition among states for dispute resolution business similar to that now existing among various arbitration institutions throughout the world.

B. Private International Law Competition and the European Union

The negotiation and conclusion of the Hague Convention demonstrate both competition within the European Community for authority over rules of private international law and competition by the Community to obtain the application of its own rules in a multilateral setting. While competition by the Community was demonstrated directly at the negotiations, competition within the Community was demonstrated in the evolution of Community competence for private international law matters, a process that paralleled the negotiation of the Hague Convention.

I. Internal Competition for External Competence

1. The Development of Community Competence for Matters of Private International Law

Upon the creation of the European Economic Community, Article 220 of the original Treaty of Rome acknowledged that the free movement of goods, services, capital, and persons required the free movement of judgments and arbitral awards in order to complete the foundation of a functioning common market.[4] Now Article 293 of the Treaty Establishing the European Community, this Article provided the impetus and authority

[4] Treaty Establishing the European Community, art 293 (ex art 220). The current version of the TEC can be found at OJ Euro Comm C 321E/37, 29 December 2006 http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/ce321/ce32120061229en00010331.pdf [hereinafter TEC or European Community Treaty] ("Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals: . . . – the simplification of formalities governing the reciprocal recognition and enforcement of judgments of courts or tribunals and of arbitration awards.").

for negotiation of the 1968 Brussels Convention on jurisdiction and enforcement of judgments.[5]

When the Treaty of Amsterdam entered into force on 1 May 1999,[6] it created a new focus on judicial cooperation among the Member States as part of the establishment of an area of freedom, security and justice. As a result, Article 61 of the European Community Treaty now provides that "the Council shall adopt … measures in the field of judicial cooperation in civil matters as provided for in Article 65."[7] Article 65 then describes such measures as dealing with cross-border service of judicial and extrajudicial documents, the taking of evidence, the recognition and enforcement of judgments, conflict of laws, and rules on civil procedure.[8]

The Council and Parliament of the European Community have exercised their authority under Articles 61 and 65 to enact Regulations dealing with insolvency proceedings,[9] cross-border service of process,[10] jurisdiction and the recognition of judgments in civil and commercial matters,[11] cross-border taking of evidence,[12] judicial cooperation generally,[13]

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5 European Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters, done at Brussels, 27 September 1968, 41 OJ Eur Comm C 27/1, 26 January 1998 (consolidated and updated version of the 1968 Convention and the Protocol of 1971, following the 1996 accession of the Republic of Austria, the Republic of Finland and the Kingdom of Sweden) [hereinafter Brussels Convention].

6 http://eur-lex.europa.eu/en/treaties/dat/11997D/htm/11997D.html.

7 TEC, *supra* note 4, at art 61 (ex art 73i).

8 *Ibid* at art 65 (ex art 73m).

9 Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, OJ Eur Comm L 160/1, 30 June 2000 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32000R1346:EN:HTML.

10 Council Regulation (EC) No 1348/2000 of 29 May 2000 on the service in the Member States of judicial and extrajudicial documents in civil or commercial matters, OJ Eur Comm L 160/37, 30 June 2000 http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!DocNumber&lg=en&type_doc=Regulation&an_doc=2000&nu_doc=1348.

11 Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Brussels Regulation), OJ Eur Comm L 012/1, 16 January 2001 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32001R0044:EN:HTML. The Brussels Convention remains in force for relations between Denmark and the other Member States.

12 Council Regulation (EC) No 1206/2001 of 28 May 2001 on cooperation between the courts of the Member States in the taking of evidence in civil or commercial matters, OJ Eur Comm L 174/1, 27 June 2001 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32001R1206:EN:HTML.

13 Council Regulation 743/2002 of 25 April 2002, Establishing a General Community Framework of Activities to Facilitate the Implementation of Judicial Cooperation in Civil Matters, OJ Eur Comm L 115/1, 1 May 2002 http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!DocNumber&lg=en&type_doc=Regulation&an_doc=2002&nu_doc=743.

jurisdiction and the recognition and enforcement of judgments in family law matters,[14] enforcement orders for uncontested claims,[15] payment procedures,[16] and the law applicable to contractual,[17] and non-contractual obligations.[18] Together with the Lugano Convention on jurisdiction and the enforcement of judgments,[19] these Regulations establish a rather comprehensive approach to private international law as a part of Community law.

This expanding body of Community Regulations, by its own terms, focuses primarily on private disputes that are internal to the European Union. This is consistent with the language of Article 65 of the European Community Treaty, which provides that Regulations under its authority be adopted "insofar as necessary for the proper functioning of the internal market."[20]

Articles 61 and 65 of the European Community Treaty, by referring to "the proper functioning of the internal market," left open the question of whether competence for negotiation of the harmonization of private international law with parties outside the European Union lies exclusively with the EU Member States, exclusively with the Community institutions, or in a mixed form with Member States and Community institutions each having competence for some, but not all, issues. This question was answered by the European Court of Justice in 2006 in the *Lugano Convention* case, *Opinion 1/03*,[21] when the Court reviewed the question of competence to sign the Lugano Convention.

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14 Council Regulation 2201/2003 of 27 November 2003, concerning jurisdiction and the recognition and enforcement of judgments in matrimonial matters and the matters of parental responsibility (repealing Council Regulation 1347/2000) (Brussels II), OJ Eur Comm L 338/1, 12 December 2003 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32003R2201:EN:HTML.

15 Regulation 805/2004 of the European Parliament and of the Council of 21 April 2004 creating a European Enforcement Order for uncontested claims, OJ Eur Comm L 143/15, 30 April 2004 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004R0805:EN:HTML.

16 Regulation 1896/2006 of the European Parliament and of the Council of 12 December 2006 creating a European order for payment procedure, OJ Eur Comm L 399/1, 30 December 2006 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:399:0001:01:EN:HTML.

17 Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), OJ Eur Comm L 177/6, 4 July 2008 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:177:0006:0016:EN:PDF.

18 Regulation 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II), OJ Eur Comm L 199/40, 31 July 2007 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:199:0040:01:EN:HTML.

19 European Communities-European Free Trade Association: Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters, done at Lugano, September 16, 1988, OJ Eur Comm. L 319/9, 25 November 1988 [Lugano Convention].

20 TEC, *supra* note 13, at art 65.

21 Opinion 1/03 of 7 February 2006, Request by the Council of the European Union for an Opinion pursuant to Article 300(6), (2006) ECR I-1145. The opinion procedure under Article 300(6) is used only occasionally, and is separate from the normal "case" procedure by which most matters reach the European Court of Justice. *See* Opinion 1/03, Request by the Council of the European Union for an Opinion pursuant to Article 300(6), E.C. Official Journal C 101/1 26 April 2003.

The European Court's earlier decisions in the 1971 ERTA case,[22] and the *Open Skies* judgments of 2002,[23] provided that Community exercise of internal competence otherwise granted in basic Community legal instruments results in Community capture of external competence if any external rules might "affect or distort" the internal regime, or the rules resulting from the exercise of internal competence have achieved "complete harmonisation in a given area."[24] Thus, in the *Lugano Convention* opinion, the Court found that the Brussels I Regulation created a "unified and coherent system of rules on jurisdiction," and concluded that "any international agreement also establishing a unified system of rules on conflict of jurisdiction such as that established by that regulation is capable of affecting those rules of jurisdiction."[25]

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[22] Case 22/70, Judgment of 31 March 1971, Commission v Council && 17,18 (1971) ECR 263 (ERTA) ("[E]ach time the Community, with a view to implementing a common policy envisaged by the Treaty, adopts provisions laying down common rules, whatever form these may take, the Member States no longer have the right acting individually or even collectively, to undertake obligations with third countries which affect those rules," and "the Community alone is in a position to assume and carry out contractual obligations towards third countries affecting the whole sphere of application of the Community legal system.").

[23] Judgments of 5 November 2002, Case C-467-98, Commission v Denmark [2002] ECR I-9519; Case C-468/98, Commission v Sweden (2002) ECR I-9575; Case C-469/98, Commission v Finland (2002) ECR I-9627; Case C-471/98, Commission v Belgium (2002) ECR I-9681; Case 472/98, Commission v Luxembourg (2002) ECR I-9741; Case C-475/98, Commission v Austria (2002) ECR I-9797; and Case C-476/98, Commission v Germany (2002) ECR I-9855.

[24] *Ibid.* Part of the decision in *Commission v. Denmark* stated:

> [81] It must next be determined under what circumstances the scope of the common rules may be affected or distorted by the international commitments at issue and, therefore, under what circumstances the Community acquires an external competence by reason of the exercise of its internal competence.
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> [82] According to the Court's case-law, that is the case where the international commitments fall within the scope of the common rules (ERTA judgment, paragraph 30), or in any event within an area which is already largely covered by such rules (Opinion 2/91, paragraph 25). In the latter case, the Court has held that Member States may not enter into international commitments outside the framework of the Community institutions, even if there is no contradiction between those commitments and the common rules (Opinion 2/91, paragraphs 25 and 26).
>
> [83] Thus it is that, whenever the Community has included in its internal legislative acts provisions relating to the treatment of nationals of non-member countries or expressly conferred on its institutions powers to negotiate with non-member countries, it acquires an exclusive external competence in the spheres covered by those acts (Opinion 1/94, paragraph 95; Opinion 2/92, paragraph 33).
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> [84] The same applies, even in the absence of any express provision authorising its institutions to negotiate with non-member countries, where the Community has achieved complete harmonisation in a given area, because the common rules thus adopted could be affected within the meaning of the ERTA judgment if the Member States retained freedom to negotiate with non-member countries (Opinion 1/94, paragraph 96; Opinion 2/92, paragraph 33).

[25] Opinion 1/03, *supra* note 21, at & 151.

Based on this test, the Court determined that "the provisions of the new Lugano Convention relating to the rules on jurisdiction … affect the uniform and consistent application of the Community rules on jurisdiction and the proper functioning of the system established by those rules."[26] Because the Lugano Convention "would affect the uniform and consistent application of the Community rules as regards both the jurisdiction of courts and the recognition and enforcement of judgments and the proper functioning of the unified system established by those rules,"[27] the Court held that the conclusion of the Convention "falls entirely within the sphere of exclusive competence of the European Community."[28]

The *Lugano Convention* opinion thus resolved the competition for competence between the Member States and the Community institutions in the area of private international law, at least in regard to common rules of jurisdiction and the recognition and enforcement of judgments. In this example, that competition was resolved through a combination of initial ceding of authority from Member States to the Community institutions in the Treaty of Amsterdam, followed by the subsequent exercise of internal competence, and the analysis of the result of that exercise in light of Community jurisprudence relating to external competence. This process is not one likely to be subjected to economic analysis as a type of marketplace competition. It was, nonetheless, a process of competition in which the trade lawyers in Brussels garnered authority for matters once considered the province of private international law experts within the Member States. To the extent these matters, traditionally considered to be within the realm of private international law, were captured by the trade law system, however, the process recognized the importance of the free movement of judgments to a functioning common market – a matter very much subject to economic analysis.[29]

2. Community/Member State Competition for External Competence at the Hague Conference on Private International Law

The decision in the *Lugano Convention* opinion demonstrates the success of Community trade lawyers in competition with Member State private international law lawyers in affecting the evolution of Community law. While it may appear to represent a natural step in the evolution of Community Law from the free movement goods, services, capital, and persons, to the free movement of the judgments of national courts that give final value to such resources, it clearly was not a conclusion easily accepted by all parties affected by the process. The *Lugano Convention* Opinion also makes clear the exclusive role of the Community institutions in the negotiation of multilateral conventions dealing with issues of jurisdiction and the recognition and enforcement of judgments.

Despite the fact that the *Lugano Convention* Opinion was not rendered until 2006, the Council and Commission of the European Community had begun earlier to engage in concerted negotiations of external instruments at the Hague Conference on Private

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26 *Ibid* at & 161.

27 *Ibid* at & 172.

28 *Ibid* at & 173.

29 *See* Ronald A. Brand, *Recognition of Foreign Judgments as a Trade Law Issue: The Economics of Private International Law,* in Jagdeep Bhandari and Allen O. Sykes (eds.), *The Economic Analysis of International Law* (1998) 592.

International Law on matters of jurisdiction and the recognition and enforcement of judgments.[30] The negotiations for the Hague Convention on Choice of Court Agreements[31] (originally planned to be a broader convention on jurisdiction and judgments) began in 1992. In the early stages, each EU Member State was fully involved. In the end, however, the European Community and its Member States were represented by the single voice of the Commission. The negotiations ended not only with the completion of the 2005 Choice of Court Convention, but also with amendment of the Statute of the Hague Conference on Private International Law, providing for Conference membership for Regional Economic Integration Organizations, a term which currently is effective as a practical matter to describe only the European Community.[32]

During the negotiation process, it seemed that the private international law experts representing EU Member States at The Hague were quite unaware of the contemporaneous efforts in Brussels to expand community competence for private international law matters through the Treaty of Amsterdam. They obviously were not fully comfortable with giving their negotiating role over to lawyers from the Commission and Council, who were officially at the meetings only as "observers" because they did not represent a Hague Conference Member State. To the extent this can be viewed as a competitive process, the game was pretty easily won in Brussels. The European Community became an official Member of the Hague Conference on Private International Law on 3 April 2007,[33] and henceforth will exercise its competence in private international law matters directly in future negotiations, whether that competence is exclusive or mixed with the EU Member States in the areas of law being considered.

The Brussels system encompasses states from both common law and civil law traditions. When the original Brussels Convention was completed in 1968, however, all six original Member States of the European Economic Community had civil law legal systems. Thus, the Brussels Convention provides a set of rules on jurisdiction and the recognition and enforcement of judgments that reflects civil law traditions. When the

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30 The allocation of competence may have implications as well for negotiations in the United Nations Commission on International Trade Law (UNCITRAL) and the Institute for Unification of International Private Law (UNIDROIT).

31 The text of the Convention on Choice of Court Agreements may be found at: http://hcch.e-vision.nl/index_en.php?act=conventions.text&cid=98.

32 *See* Final Act of the Twentieth Session of the Hague Conference on Private International Law, 20 June 2005.

33 "The European Community becomes Member of the HCCH", press release of 3 April 2007 http://www.hcch.net/index_en.php?act=events.details&year=2007&varevent=129. While the European Union is comprised of the European Community and Euratom, and includes two areas of intergovernmental co-operation, namely common foreign and security policy (CFSP) and police and judicial co-operation in criminal matters, it does not have legal personality. Only the European Community has legal personality and can act on behalf of the Community institutions. *See* http://europa.eu/scadplus/glossary/union_legal_personality_en.htm. The Reform Treaty proposed by the Brussels European Council of 21-22 June 2007 provides that the "European Union" will replace the "European Community", removing confusion and simplifying both structure and terminology. The Treaty establishing the European Community would also be renamed the Treaty on the functioning of the Union. This change would have occurred if the Treaty Establishing a Constitution for Europe had gone into effect, a result prevented by several negative national referendum votes.

United Kingdom joined the Community in 1973, it acceded to the Brussels Convention without renegotiation, thus becoming a part of what was very much a civil law system of rules. The competition in this realm was easily won by the civil law side. At least one result has been the uncomfortable co-existence of the doctrine of *forum non conveniens* in the United Kingdom alongside the strict *lis pendens* rules of the Brussels Convention and Regulation.[34]

II. External Competence and External Competition on the Part of the European Community in Negotiating the Hague Convention on Choice of Court Agreements

1. Selling the Brussels Convention to the World

The US request in 1992 that the Hague Conference on Private International Law take up a convention on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, was accompanied by a report by Professor Arthur T. von Mehren proposing a "mixed convention" structure, but using provisions of the Brussels Convention as examples in his discussion.[35] Once negotiations were begun in 1996, the Brussels Convention became the model from which most discussions originated, resulting in a 1999 Preliminary Draft Convention text that looked very much like the text of the Brussels Convention.[36] This was not surprising, given a majority vote rule at the Hague Conference and the fact that over half of the states actively involved in negotiations were, or were soon to become, Member States of the European Community.

Both the Community Member States and the Community institutions lobbied for inclusion in the Hague instrument of rules as much like those in the Brussels Convention as possible. While the delegations from many non-EU states, particularly those with civil law legal systems, were quite receptive to this approach, not all Brussels Convention rules were appropriate for a global convention, and the United States delegation, in particular, was not ready (and in some instances not constitutionally able) to accept some of the rules of the Brussels Convention. Thus, while the Brussels system has grown stronger within the European Union through the addition of new Member States and the continuing evolution of its interpretation by the European Court of Justice, it has not (yet) become the mold for forging a global convention.

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[34] *See, eg*, Ronald A. Brand, *Balancing Sovereignty and Party Autonomy in Private International Law: Regression at the European Court of Justice*, in Johan Erauw, Vesna Tomljenovic and Paul Volken (eds.), *Universalism, Tradition and the Individual, Liber amicorum dedicated to Professor Petar Šarčević* (2006) 35.

[35] Arthur T von Mehren, *Recognition Convention Study: Final Report*.

[36] The text of the Preliminary Draft Convention is available at http://www.hcch.net/e/conventions/draft36e.html.

2. Competing for External Effect of Internal Community Legislation

The negotiations that led to the Hague Convention on Choice of Court Agreements not only provide context from which the evolution of Community competence for issues of private international law can be reviewed and measured, they also provide lessons about the role of the European Community as a player in the process of development of multilateral rules dealing with private international law. These lessons were perhaps most evident in the negotiation of two articles of the Choice of Court Convention. These Articles deal with what is commonly referred as to the "disconnection" issue; the relationship of the multilateral convention to both pre-existing and future treaties dealing with the same or similar issues.

The draft text prepared by the April 2004 Special Commission in preparation for the 2005 Diplomatic Conference of the Hague Conference included Articles 23 and 26 dealing with the relationship between the Convention and other "international instruments," and with "Regional Economic Integration Organisations," respectively.[37] Draft Article 23 provided rules dealing with the relationship of the Convention to other treaties, but with a new dimension. Rather than referring to other "conventions," it referred to other "international instruments." Consider the following parts of this draft article:

> *Article 23 Relationship with other international instruments*
>
> 1. For the purposes of this Article, "international instrument" means an international treaty or rules made by an international organisation under an international treaty.
>
> 2. Subject to paragraphs 4 and 5, this Convention does not affect any international instrument to which Contracting States are parties and which contains provisions on matters governed by this Convention, unless a contrary declaration is made by the Contracting States bound by such instrument.
>
> 3. …
>
> 4. Where a Contracting State is also a party to an international instrument which contains provisions on matters governed by this Convention, this Convention shall prevail in matters relating to jurisdiction except where –
>
> a) the chosen court is situated in a State in which the instrument is applicable; and
>
> b) all the parties are resident[only] either in a State in which the instrument is applicable or in a non-Contracting State.

The transition from the Brussels Convention (a treaty) to the Brussels Regulation (internal Community legislation) meant that standard reference to "conventions" would no longer provide a proper "disconnection" between the Hague Convention and the applicable European Community rules. New language was required; hence the use of "international instruments." But the term itself begs the question: what is an "international instrument"? Draft Article 23(1) would have provided a definition that would include any "international treaty or rules made by an international organisation under an international treaty." Since the Brussels Regulation became Community law pursuant to Articles 61 and 65 of the European Community Treaty, it would have been covered by

[37] Hague Conference on Private International Law, Special Commission on Jurisdiction and the Recognition and Enforcement of Judgments, Working Document No 110 Revised, May 2004.

this definition. Thus, draft Article 23(2) would have established a general rule that the Brussels Regulation prevails over the Hague Choice of Court Convention (*ie*, the Hague Convention "does not affect" the operation of the Regulation). Without more, this would mean that the Brussels Regulation would govern all litigation in Europe in which the defendant was domiciled in a Member State of the European Union, even if brought by a plaintiff from a Hague Convention state that is outside the EU. This obviously would have been an unbalanced result.

This imbalance was partially adjusted by paragraph (4) of draft Article 23, which provided that (for purposes of the jurisdictional rules only) the Hague Convention would prevail over the Brussels Regulation unless both the chosen court is within the EU and the parties to the dispute are all resident in EU Member States (or in states which are not Hague Contracting States). Thus, as to the jurisdictional rules, in most cases the Hague Convention would have prevailed over the Brussels Regulation in the courts of EU Member States.

While the operation of draft Article 23 may have seemed logical on its own, when combined with draft Article 26 it raised special questions of European evolution of competence in private international law. Article 26(1) of the April 2004 draft text read as follows:

> *Article 26 Regional Economic Integration Organisations*
>
> 1. A Regional Economic Integration Organisation which is constituted by sovereign States and has competence over some or all of the matters governed by this Convention may equally sign, accept, approve or accede to this Convention. The Regional Economic Integration Organisation shall in that case have the rights and obligations of a Contracting State, to the extent that the Organisation has competence over matters governed by this Convention.

This provision foresaw the possibility of the Community becoming a party to the Hague Convention on Choice of Court Agreements, and taking on both the rights and obligations that would entail. When combined with draft Article 23, however (and particularly with draft Article 23(2)), it would have given a Contracting State that is also a "Regional Economic Integration Organisation" the ability unilaterally to amend its own obligations under the Convention. Because the Community can enact internal legislation under Articles 61 and 65 of the European Community Treaty (in the form of a regulation) that is for purposes of the Hague Convention an "international instrument," and because such an instrument would have prevailed over the Hague Convention by way of draft Article 23(2), the combination of these provisions presented an imbalance in the rights and obligations of Contracting States that was incongruous with normal treaty operation.

These issues were addressed at the Diplomatic Conference in June 2005 by making the rules regarding the relationship of the Hague Convention to treaties separate from the rules regarding the relationship of the Convention to European Community Regulations. While the first five paragraphs of the final Article 26 ("Relationship with other international instruments") contain rules generally consistent with the Vienna Convention on the Law of Treaties and customary international law,[38] the sixth paragraph specifically addresses instruments of Regional Economic Integration Organisations as follows:

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[38] Hague Convention on Choice of Court Agreements, *supra* note 31, art 23(1)-(5).

> 6. This Convention shall not affect the application of the rules of a Regional Economic Integration Organisation that is a Party to this Convention, whether adopted before or after this Convention –
>
> *a)* where none of the parties is resident in a Contracting State that is not a Member State of the Regional Economic Integration Organisation;
>
> *b)* as concerns the recognition or enforcement of judgments as between Member States of the Regional Economic Integration Organisation.[39]

The result of the paragraph (6)(a) provision on jurisdiction (admittedly an awkward double negative) is that the Brussels Regulation will not apply simply because the defendant is domiciled in an EU Member State (as is generally the case), but only when all of the parties are resident in EU Member States. On the recognition and enforcement of judgments, however, the Brussels Regulation will continue to apply to intra-EU judgments, regardless of the residence of the parties to the underlying action.

The language of draft Article 26 on Regional Economic Integration Organisations was left basically unchanged in what became Article 29 of the final text, continuing to allow an REIO such as the European Community to become a party to the Convention "to the extent that the Organisation has competence over matters governed by this Convention."[40] With the new rule in Article 26(6), however, the Hague Convention will govern questions of jurisdiction whenever there is at least one party resident outside the European Union, and the Community will thus not have the opportunity for unilateral amendment of jurisdictional result. While the Community rules on recognition and enforcement will apply within the European Union, that result was considered acceptable given the generally more favorable rules for recognition and enforcement under the Brussels Regulation and the acknowledged, but unstated, desire to treat the Community similar to a federal unit on this issue.

C. Internal Competition Within the United States

Competition for competence on issues of jurisdiction and the recognition and enforcement of judgments is not unique to the European Union, but has been occurring in the United States for more than a century. This competition has dealt mostly with internal competence, however, with little doubt that competence to negotiate an international treaty on such matters lies exclusively with the federal government.

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[39] *Ibid* art 23(6).

[40] *Ibid* art 29(1).

I. Common Law Foundations of a Comity Approach to the Recognition of Foreign Judgments

In the 1985 case of *Hilton v Guyot*,[41] the Supreme Court of the United States took it upon itself to determine the law applicable to an effort by a French party to enforce a French judgment against a US party in Federal District Court for the Southern District of New York. The court applied federal common law to determine that comity generally weighs in favor of giving effect to foreign judgments,[42] but that a rule of reciprocity applies as a matter of international law and, because a French court would not clearly recognize and enforce a judgment from the Federal District Court in New York, the judgment should not be recognized by the US court.

Forty-three years later, the Supreme Court effectively modified the *Hilton* result in *Erie Railroad v Tompkins*,[43] when it denied the existence of a general federal common law, determining that a federal district court should apply both the statute and common law of the state in which it sits. Subsequent cases have applied *Erie* to find that state law governs the recognition and enforcement of judgments in US federal courts.[44] This approach has been catalogued in the *Restatement of Foreign Relations Law*.[45]

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41 159 US 113 (1895).

42 Justice Gray began by defining comity:

> Comity, in the legal sense, is neither a matter of absolute obligation on the one hand, nor a mere courtesy and good will upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive, or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.

159 US at 163-64. He later found that the application of comity generally required the recognition of foreign judgments:

> [W]here there has been opportunity for a full and fair trial abroad before a court of competent jurisdiction, conducting the trial upon regular proceedings, after due citation or voluntary appearance of the defendant, and under a system of jurisprudence likely to secure an impartial administration of justice between the citizens of its own country and those of other countries, and there is nothing to show either prejudice in the court, or in the system of laws under which it was sitting, or fraud in procuring the judgment, or any other special reason why the comity of this nation should not allow it full effect, the merits of the case should not, in an action brought in this country upon the judgment, be tried afresh.

Ibid at 202-03.

43 304 US 64 (1938).

44 *See, eg*, Somportex Ltd v Philadelphia Chewing Gum Corp, 453 F2d 435 (3d Cir 1971), *cert denied*, 405 US 1017 (1972).

45 *Restatement (Third) Foreign Relations Law* §§ 481, et seq (1986).

II. Competition for Rules on the Recognition of Judgments

In 1962 the National Conference of Commissioners on Uniform State Laws (NCCUSL) promulgated the Uniform Foreign Money-Judgments Recognition Act.[46] That Act has been adopted in at least thirty states, making the rules in those states a matter of statute law. The remaining states continued to apply the common law analysis originated in *Hilton v Guyot*.

If the Hague negotiations had ended with a comprehensive convention on jurisdiction and the recognition and enforcement of judgments, ratification of such a convention by the United States would have made the law on recognition of foreign judgments a matter of federal law under the Supremacy Clause of the United States Constitution.[47] During the negotiations, two parallel initiatives were instituted. First, NCCUSL began the preparation of a new uniform law, the Uniform Foreign-Country Money Judgments Recognition Act. This act followed the 1962 Recognition Act, but with some updates and modifications. It was completed in July 2005.[48]

Also completed in 2005 was the American Law Institute's *Recognition and Enforcement of Foreign Judgments: Analysis and Proposed Federal Statute*. Originally intended to provide implementing legislation for a successful Hague Convention, this project evolved into a free-standing draft federal statute that would make the recognition and enforcement of foreign judgments a matter of federal law, thus preempting state law on the matter.

The three separate instruments now available for dealing with the recognition and enforcement of foreign judgments in the United States can not all exist in parallel. While ratification of the Hague Convention on Choice of Court Agreements could occur in tandem with either the new Uniform Act or the ALI federal statute, the Uniform Act and ALI statute would be in conflict, with that conflict being resolved by the Supremacy Clause of the United States Constitution in favor of the federal statute. This sets up a federalism debate that is likely to continue for some time in the United States, with competition between those favoring retaining foreign judgment recognition law at the state level and those favoring the federalization of such legal rules.

D. The Harmonization of Global Rules on Private International Law and the Resulting Market for Commercial Dispute Resolution: Is There a Role for a Magnet International Commercial Court?

If the Hague Choice of Court Convention should gain broad acceptance, it will have several significant competitive effects. First, it will serve to add some balance to the playing field between international arbitration and international litigation. While transactions lawyers often justify inclusion of arbitration clauses in transnational contracts by reference to the benefits of enforcement of arbitration awards under the New York Arbitra-

46 Uniform Foreign Money-Judgments Recognition Act, 13 ULA 263 (1986).

47 US Const art VI.

48 *See* http://www.nccusl.org/Update/DesktopModules/NewsDisplay.aspx?ItemID=147.

tion Convention,[49] the existence of a Choice of Court Convention that would provide similar enforcement protection for court judgments would require more careful analysis of the respective advantages and disadvantages of arbitration versus litigation in a given transaction. This would change the competition between arbitration and litigation as forms of dispute resolution.

A second competitive effect of widespread ratification of the Choice of Court Convention is indicated by implication of Article 19 of that Convention:

> *Article 19 Declarations limiting jurisdiction*
> A State may declare that its courts may refuse to determine disputes to which an exclusive choice of court agreement applies if, except for the location of the chosen court, there is no connection between that State and the parties or the dispute.

While Article 19 allows a state by declaration to avoid having international disputes settled in its courts, by not exercising the right to such a declaration a state may decide that it wants to attract such disputes. It is not difficult to imagine commercial courts in London or New York, and their associated bars, developing special expertise in international commercial matters, with the result that merchants would be inclined to place particular trust in those courts for the settlement of transnational disputes. The effect would be similar to the existing competition among the various international arbitration institutions for the business of transnational dispute resolution.

One of the ironies of the Hague negotiations leading up to the Convention on Choice of Court Agreements was that much of the discussion was targeted not at rules of jurisdiction and the recognition and enforcement of judgments, but rather at the procedures applied once jurisdiction exists in certain states. Efforts to target "general doing business" jurisdiction in the United States were often justified by reference to rules on discovery, and the availability of juries and punitive damages, rather than to any real concern with the jurisdictional rule itself. If transnational merchants do not want such procedures and remedies applied to their disputes, then the effect of a global Convention on Choice of Court Agreements might be that states seeking to develop magnet commercial courts will remove those elements in order to attract judicial business. If that happens, then the Choice of Court Convention may in fact be able to solve some of the problems the negotiations for a more comprehensive convention were not able to solve. It would indeed be interesting if a Choice of Court Convention and a bit of market competition between commercial courts could accomplish what dozens of negotiators could not accomplish at The Hague.

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[49] United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done at New York, 10 June 1958, 21 UST 2517, TIAS No 6997, 330 UNTS 38 [hereinafter New York Convention] http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NY Convention.html.

E. Conclusion

The continuing evolution of global markets and a resurgence of the type of respect for party autonomy that characterized the medieval *lex mercatoria* mean that private parties in their commercial relationships do (or at least should) give careful consideration to the choice of forum for dispute settlement and the choice of legal rules to be applied to those relationships. When business parties have such choices, and when legal rules differ in the domestic legal systems available to be chosen, parties compare and choose the set of rules they consider most appropriate for their relationships. To the extent that states desire either to obtain legal services business through private party choice of forum, or to gain influence (and perhaps regulatory revenue) through private party choice of law, these choices involve a competition of legal systems. The realm of private international law, applicable when parties have not made such a choice, provides its own layer of competition by raising questions about whether harmonization of private international law rules affects competition.

The negotiation and conclusion of the Hague Convention on Choice of Court Agreements demonstrates both competition within the European Community for authority over rules of private international law and competition by the Community to obtain the application of its own rules in a multilateral setting. If the Convention becomes widely ratified, this competition *in* the harmonization of private international law may well lead to competition *from* the harmonization of such law, with states using the new rules to compete for the business of dispute resolution, just as international arbitration institutions now compete for the business of arbitration. That process could, in turn, lead to changes in legal systems beyond rules on jurisdiction and the recognition and enforcement of judgments through a competitive market for commercial court services, bringing even further harmonization of law through market forces.

The European Constitution and Interjurisdictional Competition

Roland Vaubel[*]

A. Introduction

Many eminent writers have regarded interjurisdictional competition as Europe's secret of success in the modern age. The first was David Hume in his essay "Of the Rise and Progress of the Arts and Sciences" (1742/1985, pp. 119, 122 f.):

> Nothing is more favourable to the rise of politeness and learning than a number of neighbouring and independent states connected together by commerce and policy … Their mutual jealousy keeps them from receiving too lightly the law from each other in matters of taste and reasoning … Europe, of all four parts of the world, is the most broken by seas, rivers and mountains; and Greece of all countries of Europe. Hence, these regions were naturally divided into several distinct governments. And hence the sciences arose in Greece; and Europe has been hitherto the most constant habitation of them.

The idea was taken up and developed further by *Montesquieu* in his book "L'Esprit des Lois" (1748/1989, pp. 283 f.):

> In Europe, natural divisions form many medium-sized states in which the government of laws is not incompatible with the maintenance of the state; the natural divisions are so favourable to the government of laws that without laws a state falls into decadence and becomes inferior to all the others. This is what has formed a genius for liberty …

While *Hume* emphasizes the favourable effects of interjurisdictional competition on science and innovation in general, *Montesquieu* suggests that the rule of law and the rise of liberty in Europe were due to political fragmentation. In another chapter, he argued that, since the invention of the bill of exchange and the concomitant interjurisdictional mobility of capital, "princes have had to govern themselves more wisely than they themselves would have thought" (p. 389). Thus, while interjurisdictional competition in *Hume* is "yardstick competition" which operates by way of comparison, it is based on mobility ("exit") in *Montesquieu*.

One generation further on, *Immanuel Kant* in his essay "Idea of a Universal History from a Cosmopolitan Point of View" (1784/1959, p. 31) explains the rise of civil liberty in Europe on Montesquieu's lines:

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> „Now the states are already in the present day involved in such close relations with each other that none of them can pause or slacken in its internal civilization without losing power and influence in relation to the rest … Further, civil liberty cannot now be easily assailed without inflicting such damage as will be felt in all trades and industries, and especially in commerce … This enlightenment … must by and by pass up to the throne and exert an influence even upon the principles of government".

Three years later, *Edward Gibbon* in his monumental "History of the Decline and Fall of the Roman Empire" (1787, Vol. 3, p. 636) combines *Hume's* and *Montesquieu's* explanation of Europe's success:

> "Europe is now divided into twelve powerful, though unequal, kingdoms, three respectable commonwealths and a variety of smaller, though independent states … The abuses of tyranny are restrained by the mutual influence of fear and shame … In peace, the progress of knowledge and industry is accelerated by the emulation of so many active rivals".

In the 19th century, *Lord Acton* (1877/1985, p. 21) extended both versions of the argument to democracies:

> "If the distribution of power among the several parts of the state is the most efficient restraint of monarchy, the distribution of power among several states is the best check on democracy. By multiplying centres of government and discussion it promotes the diffusion of political knowledge and the maintenance of healthy and independent opinion. It is the protectorate of minorities and the consecration of self-government".

Moreover, he explains the rise of civil liberty in Europe also by the interjurisdictional competition between the state and the church during the middle ages. As *Harold Berman*, a legal scholar, pointed out later (1998, pp. 38 f.), this was also a competition among legal orders.

The first author to explicitly apply the economic term "competition" (Wettbewerb) to this process seems to have been *Max Weber* in his "General Economic History" (1923, p. 249):

> „The competitive struggle (among the European nation states) created the largest opportunities for modern western capitalism. The separate states had to compete for mobile capital, which dictated to them the conditions under which it would assist them to power".

Since the publication of *Robert Wesson's* book "State Systems" (1978) and *Eric Jones'* book "The European Miracle" (1981), many economic historians have embraced the view that Europe's race to the top has been due to interjurisdictional competition,[1] and Jones himself emphasizes that the competition was one of legal orders:

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[1] See, e.g., North (1998), McNeill (1982, p. 114), Bernholz (1985), Hall (1985, p. 102), Chirot (1986, p. 296), Rosenberg and Birdzell (1986, pp. 136 ff.), Kennedy (1987, pp. 19 f.), Engerman (1988, p. 14), Weede (1988, 2000), Mokyr (1990, p. 302; 2003, p. 18) and Murray (2003).

> The rulers of the relatively small European states learned that by supplying the services of order and adjudication they could attract and retain the most and best-paying constituents. (p. 233).

My final quote is from the American historian *David S. Landes* (1998, p. 37 f.):

> Ironically, then, Europe's great fortune lay in the fall of Rome and the weakness and division that ensued … The Roman dream of unity, authority and order (the pax Romana) remained, indeed it has persisted to the present. After all, one has usually seen fragmentation as a great misfortune, a recipe for conflict … And yet … fragmentation was the strongest brake on wilful, oppressive behavior. Political rivalry and the right of exit made all the difference.

In view of these insights,[2] Europe's current quest for political and legal unification may destroy the very mechanism on which Europe's success has been based. As *Arnold Toynbee* in his monumental "Study of History" (1939) has suggested, the decline of a civilisation is usually associated with standardisation (Vol. VI, p. 322), and the final collapse tends to be preceded by the establishment of a unitary political structure (Vol. VI, pp. 283 ff., 327).

B. The Effect of European Integration on Interjurisdictional Competition

European integration consists of two parts: market integration and political integration. Market integration is brought about by removing the national legal barriers to trade, capital movements and migration. By facilitating exit, market integration strengthens interjurisdictional competition. Thus, it does not only increase efficiency but also freedom.

To secure international market integration, it may be helpful or even necessary to have international institutions (a civil service and/or a court) which act as guardians of the treaty. But experience shows that such international institutions use their competencies to enlarge their power by centralizing and "harmonizing" political decision making at the union level. Moreover, since international market integration, by facilitating exit, constrains the power of national politicians, the latter are increasingly willing to give up independent national decision making and agree to joint decision making at the union level. The result is political integration i.e., political centralization. Unlike market integration, political centralization gives the state more power over the citizens. Thus, political integration is a threat to individual freedom.

The European Community/Union suppresses interjurisdictional competition by approximating and centralizing legislation especially in the fields of taxation and regulation. (By regulation, economists mean interference with the freedom of contract).

The most spectacular case of tax "harmonization" was the Value Added Tax Directive of 1992. It introduced a minimum VAT rate exceeding the prior tax rates of three member states, including Germany. The German government had tried to raise VAT by national

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[2] For a more complete survey see my *History of Thought on Institutional Competition* (Vaubel 2008).

legislation but had failed to obtain parliamentary approval. However, by colluding with the other members of the Council of Ministers in Brussels, the German government got what it wanted. The German parliament was obliged to implement the European directive adopted by the governments. Approval by the European Parliament was not required. Whoever thought that, in a democracy and especially in matters of taxation, government is controlled by parliament had to recognize that, in this case, the national parliaments were controlled by their governments. Why did the Ministers of Finance raise the average tax rate in the Community? The theory of interjurisdictional competition may provide the answer: by setting up a tax cartel, the governments of the member states managed to increase their revenue and their power.

However, the main activity of the European Community/Union is regulation. This is because the spending power of the Community is severely restricted. As spending decisions are largely taken by majority, while revenue decisions have to be taken unanimously, the net contributors hesitate to give more money whose use they cannot control. Since the European institutions have considerable competencies but little money, they focus on regulation – especially of labour, financial and product markets. Regulation does not cost them anything – its cost has to be borne by those who have to comply with it. Interference with the freedom of contract may be justified where the contract is concluded at the expense of third parties (e.g., among the participants of a cartel or possibly a merger) but it is highly problematic in most other cases and usually inferior to tax/subsidy schemes or liability rules which internalize the "external effects" without restricting individual choice.

Since the ratification of the European Single Act (1986), which introduced qualified majority voting in some fields of labour regulation, the European Community/Union has adopted several dozens of labour market regulations. The most important ones are listed in Table 1.[3] Most of these directives were passed after the Treaty of Maastricht (ratified in November 1993) had extended the applicability of qualified majority voting in the field of labour market regulation even further.

Are these directives due to a regulatory cartel among the national ministers of labour, or does a qualified majority of highly regulated member states impose their high level of regulation on the more liberal minority so as to raise their own competitiveness (the so-called "strategy of raising rivals' costs")? It goes without saying that a regulatory cartel presupposes unanimity but unanimity is also consistent with the strategy of raising rivals' costs. If the more liberal minority is too small to veto the legislation anyway, it may refrain from openly contesting the decision because it fears retaliation from the majority in future European legislation as well as attacks from opposition parties at home. They would face the difficulty of explaining to their voters why the majority of member governments and the domestic opposition are wrong. Thus, open disagreement is a sufficient but not a necessary condition for the strategy of raising rivals' costs.

Analyses of voting in the Council since 1994 reveal that about one fifth of EC legislation is actually contested and that, "in general, the Northern delegations tend to support more market-based solutions than the Southern delegations" (Thomson, Bourefijn, Stokman 2004, p. 256).[4] The three most important labour market regulations to be

[3] Labour market regulations are also promoted by other international organizations like the International Labour Organization and the World Trade Organization. The same objections apply.

[4] A North-South cleavage in Council voting is also reported by Beyers, Dierickx (1998: 312), Mattila, Lane (2001: 45), Elgström et al. (2000: 121) und Zimmer et al. (2005).

contested in the Council were the Working Time Directive (1993), the European Works Councils Directive (1994) and the Directive on Safety and Health Requirements for the Use of Work Equipment (1995). The Informing and Consulting Employees Directive (2002) was formally adopted by unanimity but two member states (the UK and Ireland) had voiced their opposition during the negotiations. A similar case was the Droit de Suite Directive (2001) which regulates the remuneration of artists.[5] The UK, Ireland, the Netherlands and Austria tried to stop it but they lacked a blocking minority. A clear instance of the strategy of raising rivals' costs is the Temporary Agency Work Directive proposed by the Commission in 2002 and initially blocked by a minority coalition including the UK, Germany, Denmark, Ireland and, after the Eastern enlargement, Poland. However, following the change of government in Poland (2007), the directive has been adopted in 2008. The most prominent financial market regulation to be openly but unsuccessfully opposed by a minority coalition (the UK, Ireland, Luxembourg, Sweden and Finland) was the Financial Services Directive (2003).

C. How to check the centralizing dynamic: the reform proposals of the European Constitutional Group

The European Constitutional Group – a group of 17 professors and think-tankers (lawyers, economists, historians, political philosophers etc.) from all over Europe – has proposed a "constitutional treaty" which would check the centralizing dynamic in Europe. Our first draft appeared in 1993. In the light of later events, we revised it in 2003 (published 2004) and 2007 (2007a). In our view, the purpose of a constitution is to limit the power of government. We believe that the current treaties (as well as the Lisbon Treaty) fail to limit the power of government at the European level to a sufficient extent. The "constitutional treaty" which we envisage is a treaty that settles these constitutional matters. It is a treaty in form but a constitution in substance.[6]

In the following, I shall summarize our proposals for each European institution in turn and explain our main rationale.

I. The European Commission

A) The Commission loses its right of legislative initiative.

B) Parliament and the Council receive the right of legislative initiative.

C) The Commission is obliged to assist the Council.

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[5] As the Droit de Suite Directive is not a labour market regulation interfering with the freedom of contract between worker and employer, it is not listed in Table 1. Officially it is called the "Directive on the Resale Right for the Benefit of the Author of an Original Work of Art" (2001/84/EC).

[6] It is in this sense that the European Court of Justice, too, has called the EC Treaty „a constitutional document".

Ad A): Currently, the Commission has the monopoly of legislative initiative. Since the Treaty of Maastricht (1993), it is true, Council and Parliament may "request" the Commission to submit legislative proposals (Art. 208, 192) but the Commission has explained as early as 1995 that it does not feel bound by such requests (SEC (95) 731, 14). As a result, European legislation is a one-way street in the direction of more centralization. The Commission has a vested interest in centralization because this increases its power. It does not usually propose decentralizing measures. This is inconsistent with the principle of subsidiarity. The main point is that the Commission must not have a monopoly of legislative initiative. But as an unelected bureaucracy whose members are nominated by the Council, it should probably not be entitled to propose legislation at its own initiative at all.

Ad B): The members of the European Parliament and the Council are elected politicians. They should have the right of legislative initiative. The European Parliament is probably the only parliament in the world which does not have the right to introduce legislation.

Ad C): As an unelected bureaucracy, the Commission ought to be subordinated to the Council, i.e., elected politicians. Members of the Council may play a double executive role at the European level and the level of their member state (just as Fürst Bismarck was German Imperial Chancellor and Prime Minister of Prussia at the same time).

II. The European Parliament

A) Add a second chamber composed of representatives of the national parliaments (determined by lot), and reduce the size of the first chamber (at present 785 members).

B) The second chamber shall be entitled to block legislation which it considers incompatible with subsidiarity.

C) Legislative proposals which simplify or annul previous legislation and which have received the approval of the Second Chamber must not be blocked by the First Chamber.

Ad A): Like the Commission, the members of the European Parliament have a vested interest in centralization at the Union level because such centralization increases their power. To eliminate the centralist bias, legislative decisions about the allocation of competencies between the Union and the member states have to be taken by other institutions than legislative decisions within the competency of the Union. Moreover, subsidiarity is more likely to be respected by the members of the parliaments of the member states than by the members of the European Parliament (which, since 1979, have been directly elected). A representative survey among European and national parliamentarians as well as the citizens has demonstrated that the European parliamentarians prefer more powers to be transferred to the European level than the national parliamentarians and the citizens do (European Representation Study, Schmitt, Thomassen 1999, Table 3.1.). As in the republican constitutions of ancient Athens and Venice (1335-1797), the representatives of the national parliaments are to be determined by lot to avoid self-

selection. Otherwise, there is the danger that mainly those who are most enthusiastic about European integration try to be nominated for the Second European Chamber (as seems to be the case in selecting the members of subcommittees on European affairs within the national parliaments).

Ad B): The Second Chamber decides whether a legislative proposal of the First Chamber or the Council concerns the allocation of powers between the Union and the Member States. If so, it decides whether it approves the legislation or not. It is not entitled to alter the proposal. If, it its view, the legislative proposal does not touch upon the issue of subsidiarity, it passes the bill on to the First Chamber or the Council, respectively, without further comment. This procedure is designed to check the centralizing dynamic in European secondary or ordinary legislation.

Ad C): In some fields, it may be necessary to simplify legislation (regulation!) or repatriate decisions (e.g., agricultural and structural policies). As neither the Commission nor the First Chamber is interested in ceding power, it must become possible to adopt decentralizing legislation without their consent. We suggest that such legislation may be introduced by the Council and, without change, be adopted by the Second Chamber. It would, of course, be subject to judicial review.

III. The European Court of Justice

A) The justices of the European Court of Justice shall serve one eight year term without re-appointment.

B) A European Court of Review will be added which decides all cases potentially involving the allocation of competencies between the Union and the member states.

C) The European Court of Review is composed of justices delegated by the highest courts of the member states for a maximum of six years.

Ad A): Currently, the justices of the European Court of Justice have six year terms but may be re-appointed an indefinite number of times, and very many are re-appointed at least once. The mean term length has been 9.3 years (Voigt 2003). The prospect of re-appointment can make them dependent on the government of their home country. But courts ought to be as impartial as possible. This requires independence. Since the judges need some time to get acquainted with their new tasks, one term of six years may be too short. One eight-year term seems more appropriate.

Ad B): The justices of the European Court of Justice have a vested interest in transferring power from the member states to the European level because, by doing so, they can increase their own influence. The larger the powers of the European institutions, the more numerous, important and interesting are the cases which the European Court may decide. Cases which had been intra-national (for example, conflicts between different institutions of the same member state) and which had been decided by the constitutional courts of the member states become European cases to be decided by the European Court of Justice if the competency for the policy field is transferred to the European level – for

example, by the European Court. Thus, the justices of the European Court of Justice are as biased towards centralization as the European Commission and the European Parliament. It is not a coincidence that the European Court of Justice is frequently called a "motor of integration". Doctrines like the primacy of Community law or the direct effect of European directives have been invented by the Court – they are not in the treaties. Very similar centralizing tendencies were typical of the US Supreme Court under Chief Justice John Marshall (1801-35), during the "progressive era", the New Deal period and in the 1960s and of the constitutional courts of Australia, Austria, Canada, India etc. Alexander von Brünneck, a legal scholar, concludes his international survey (1988, p. 236): "Constitutional courts predominantly tend to expand the power of central institutions in the economic sector". Econometric cross-section analyses (*Vaubel* 1996, 2009) have demonstrated that the share of central government expenditure in total government expenditure is significantly larger in those countries in which

- a constitutional court has existed for a long time,
- the constitutional court is independent of other union institutions, and
- parliament cannot easily correct or reverse the decisions of the constitutional court because the barriers to constitutional amendment are high.

As the European Court of Justice and most national constitutional courts have a vested interest in transferring power from lower levels of government to their own level, decisions about the allocation of competencies between the different levels of government should not be taken by the same court that adjudicates cases at the union level. The tasks of European-level adjudication and adjudication between the European and the national level must be separated. Just as the European Parliament needs a second chamber, the European Court of Justice has to be complemented by another court, the European Court of Review, which is exclusively responsible for cases concerning the allocation of competencies between the European level and the member states. The European Court of Review decides whether subsidiarity is at stake (docket control). If so, it decides the case. If not, it passes the case on to the European Court of Justice. The centralist bias of adjudication at the European level must not be stopped by reducing judicial independence – quite the contrary – but by correcting the incentives. That is the economic approach.

Ad C): As in the European and national parliaments, there may be a problem of self-selection. Persons who are enthusiastic about European political integration are more likely to specialize in European law and to aim at a career in the European courts. To counter this bias, the judges of the European Court of Review ought to have judicial experience in their home country – at present only 14 out of 27 have. Ideally, they should have been members of the highest court of their home country, and they should return to it after their six year term at the European Court of Review is over. This exchange of judges between the national and the European level would also have the advantage of improving the integration between European law and the law of the member states.

IV. Participatory Democracy

A) A qualified minority of the national parliaments (one third) or of the population of the European Union (one quarter of one per cent) may petition for a referendum on any law or act that concerns the allocation of powers between the Union and the member states. The results shall be binding when supported by a two thirds majority of voters in a majority of member states.

B) Any increases to the limits of the financial framework expressed as a percentage of the Union's Gross Domestic Product shall require the support of a simple majority of voters in each of the net contributing states.

C) Amendments to the Treaty shall be drafted and adopted by an Interparliamentary Conference of the national parliaments, be submitted to referendum in each member state and be ratified by each national parliament. If the constitutional practice of the member state does not provide for popular referenda, such a referendum is not binding on the parliament of the member state.

Ad A): The European Representation Study (*Schmitt, Thomassen* 1999, Table 3.1) has revealed that even the national parliamentarians prefer more powers to be transferred to the European level than the citizens do. A possible explanation of their centralist bias is that they want to be promoted to the government and that the governments and the national parliaments have a vested interest in European regulations because market integration has eroded the regulatory power of national policy makers. The European Constitutional Group believes that, in a democracy, the citizens ought to be the ultimate sovereign. If a substantial part of the electorate does not wish to leave the interpretation of subsidiarity to the politicians, the voters themselves are entitled to decide the issue in a referendum.

Ad B): Even though the revenue of the European Community is determined by the member states acting unanimously, the preferences of national politicians involved have been shown to differ from the preferences of the citizens – the taxpayers. This is especially likely in those member states which contribute more tax revenue than they receive back from Community spending. Referenda enable the tax payers to constrain the spending decisions of the politicians in power.

Ad C): If amendments to the treaties have to be drafted by an Intergovernmental Conference as at present, the national parliaments, in ratifying the amendments, face a take-it-or-leave-it decision. This means, for example, that the parliaments of the member states cannot abolish a regulatory or tax cartel which their governments have established at the European level. That is why amendments ought to be drafted by an Interparliamentary Conference. Needless to add, the European Constitutional Group is opposed to the general empowering clause enabling the Commission and the Council to take measures even if the "Treaty has not provided the necessary powers" (TEC Art. 308). Referenda in various member states have demonstrated that the electorates do not necessarily support the treaty amendments which their parliaments are willing to ratify. Thus, there is a need for referenda.

D. Conclusion: the Lisbon Treaty

The draft treaty which the European Council has adopted in December 2007 does not take up any of these proposals. On the contrary, as the European Constitutional Group has pointed out, it "will reinforce the centralization of Europe … It gives the Union still more competencies; it extends the general empowering clause from common market matters to all EU policies; it lowers the upper majority requirement in the Council from 73.9 per cent to 65 per cent; it abandons unanimity in fields in which this is dangerous; it leaves the national parliaments powerless in EU legislation" (European Constitutional Group 2007b). The group concludes: "We call on electorates and parliaments throughout the European Union to reject the Lisbon Treaty" (op. cit.). If interjurisdictional competition has been Europe's secret of success in the modern age, this conclusion is hard to avoid.

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Table 1: Labour market directives of the European (Economic) Community since 1989

Subject matter	Date of Council Decision	Reference Nr. in Official Journal
Safety and health of workers at work	12.06.1989	OJ L 183, 29.6.1989 – (89/391/EEC)
Machinery directive	14.06.1989	OJ L 183, 29.6.1989 – (89/392/EEC)
Safety and health requirements for the workplace	30.11.1989	OJ L 393, 30.12.1989 – (89/654/EEC)
Personal protective equipment	21.12.1989	OJ L 399, 30.12.1989 – (89/686/EEC)
Display screen equipment	29.05.1990	OJ L 156, 21.06.1990 – (90/270/EEC)
Protection of workers from risks related to exposure to biological agents	26.11.1990	OJ L 374, 31.12.1990 – (90/679/EEC)
Safety and health at work of workers with a fixed-duration employment relationship or a temporary employment relationship	25.06.1991	OJ L 206, 29.07.1991 – (91/383/EEC)
Employer's obligation to inform employees of the conditions applicable to the contract or employment relationship	14.10.1991	OJ L 288, 18.10.1991 – (91/533/EEC)
Approximation of the laws of the Member States relating to collective redundancies (rev.)	24.06.1992	OJ L 245, 26.08.1992 – (92/56/EEC)
Safety and health requirements at temporary or mobile construction sites	24.06.1992	OJ L 245, 26.08.1992 – (92/57/EEC)
Safety signs and signals	24.06.1992	OJ L 245, 26.08.1992 – (92/58/EEC)
Safety and protection of health of pregnant employees	19.10.1992	OJ L 348, 28.11.1992 – (92/85/EEC)
Risks related to exposure to biological agents at work (1990)	12.10.1993	OJ L 268, 29.10.1993 – (93/88/EC)
Organization of working time	23.11.1993	OJ L 307, 13.12.1993 – (93/104/EC)
Safety and health requirements for work on board fishing vessels	23.11.1993	OJ L 307, 13.12.1993 – (93/103/EC)
Protection of young people at work	22.06.1994	OJ L 216, 20.08.1994 – (94/33/EC)
European works council	22.09.1994	OJ L 254, 30.09.1994 – (94/45/EC)
Protection of workers from risks related to exposure to biological agents (revisions)	30.06.1995	OJ L 155, 06.07.1995 – (95/30/EC)
	07.10.1995	OJ L 282, 15.10.1997 – (97/59/EC)
	26.11.1995	OJ L 335, 06.12.1997 – (97/65/EC)
Safety and health requirements for the use of work equipment (rev.)	05.12.1995	OJ L 355, 30.12.1995 – (95/63/EC)
Parental leave	03.06.1996	OJ L 154, 19.06.1996 – (96/34/EC)

Subject matter	Date of Council Decision	Reference Nr. in Official Journal
Posting of workers	24.09.1996	OJ L 18, 21.01.1997 – (96/71/EC)
Equal treatment for men and women (rev.)	20.12.1996	OJ L 46, 17.02.1997 – (96/97/EC)
Burden of proof in cases of discrimination based on sex	15.12.1997	OJ L 14, 20.01.1998 – (97/80/EC)
Part-time work	15.12.1997	OJ L 14, 20.01.1998 – (97/81/EC)
Approximation of the machinery directive (rev.)	22.06.1998	OJ L 207/1, 23.07.1998 – (98/37/EC)
Approximation relating to the safe-guarding of employees' rights in the event of transfers of businesses (rev.)	29.06.1998	OJ L 201, 17.07.1998 – (98/50/EC)
Approximation of the laws relating to collective redundancies (rev.)	20.07.1998	OJ L 225, 12.08.1998 – (98/59/EC)
Organization of working time (rev.)	22.06.2000	OJ L 195, 01.08.2000 – (00/34/EC)
Equal treatment between persons irrespective of racial or ethnic origin	29.06.2000	OJ L 180, 19.07.2000 – (00/43/EC)
Biological agents at work	18.09.2000	OJ L 262, 17.10.2000 – (00/54/EC)
Equal treatment in employment and occupation	27.11.2000	OJ L 303, 02.12.2000 – (00/78/EC)
Approximation relating to the safeguarding of employees' rights in the event of transfers of businesses (rev.)	12.03.2001	OJ L 82, 22.03.2001 – (01/23/EC)
Requirements for the use of work equipment by workers at work	11.06.2001	OJ L 195, 19.07.2001 – (01/45/EC)
Informing and consulting employees	11.03.2002	OJ L 80, 23.03.2002 – (02/14/EC)
Equal treatment of men and women (rev.)	23.09.2002	OJ L 269, 05.10.2002 – (02/73/EC)
Protection of employees in the event of the insolvency of their employer (rev.)	23.09.2002	OJ L 270, 08.10.2002 – (02/74/EC)
Aspects of the organization of working time	04.11.2003	OJ L 299, 18.11.2003 – (03/88/EC)
Machinery directive (rev.)	17.05.2006	OJ L 157, 09.06.2006 – (06/42/EC)
Social legislation relating to road transport activities	15.03.2006	OJ L 102/35, 11.04.2006 – (06/22/EC)
Exposure to optical radiation	05.04.2006	OJ L 114/3, 27.04.2006 – (06/25/EC)
Equal treatment of men and women (rev.)	05.07.2006	OJ L 204/23, 26.07.2006 – (06/54/EC)
Tempory agency work	19.11.2008	OJ L 327/9, 05.12.2008 – (08/104/EC)

Chapter 3
Other Regional Groupings

Environmental Harmonization in the SADC Region: An Acute Case of Asymmetry

Werner Scholtz[*]

A. Introduction

Free trade amongst states produces several beneficial results, such as *inter alia* potential increased economies of scale and a reduction in the cost of inputs.[1] The establishment of open markets through trade liberalisation may also result in other advantages, such as the spreading of technological progress, the sharing of ideas, the development of a common base of experience and by enhancing the prospects of harmony it may even serve to promote peace.[2] Environmentalists, however, oppose trade liberalisation on the ground that it promotes economic growth, which is incompatible with environmental conservation.[3] According to this viewpoint trade threatens the protection of the environment. This argument is, however, not always correct in assuming that trade is bad for the environment as economic growth does not *per se* threaten the environment. Pollution and resource depletion can be mitigated and counteracted. Several international treaties serve as an example.[4] Furthermore, national legislation concerning the environment provides mechanisms at domestic level to address environmental concerns. The Kuznets Curve further illustrates that economic growth is not *per se* detrimental to the protection of environmental interests. The Kuznets Curve determines that at higher levels of income *per capita*, the public demand for enhanced environmental protection in a democratic

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1 D. C. Esty and D. Gerardin, *Environmental Protection in Regional Trade Agreements: The European Community and NAFTA*, in P. Demaret and others (eds.), *Regionalism and Multilateralism after the Uruguay Round: Convergence, Divergence and Interaction* (European Interuniversity Press, Brussels 1997), 541.

2 Ibid.

3 See P. M. Johnson and A. Beaulieu, *The Environment and* NAFTA*: Understanding and Implementing the New Continental Law* (Washington, 1996), 35 *et seq*.

4 Examples include: The Montreal Protocol on Substances that Deplete the Ozone Layer (adopted on 16 September 1987, entered into force 1 January 1989); the United Nations Framework Convention on Climate Change (adopted on 9 May 1992, entered into force 21 March 1994); the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal (adopted on 22 March 1989, entered into force 5 May 1992); the Cartagena Protocol on Biosafety (adopted on 29 January 2000, entered into force 11 September 2003); and the Kyoto Protocol (adopted on 11 December 1997, entered into force 16 February 2005).

society increases and the government responds by the implementation of environmental regulations.[5] In this sense, environmental quality is a luxury good which can be obtained once liberalised trade results in an increase in income. An important qualification exists in this regard: basic social needs must be met before financial resources can be allocated for environmental regulation. This implies that poorer states may not be able to afford the transition to "environmental prosperity". Pursuing trade liberalisation therefore does not need to imply that environmental interests are ignored. Thus, trade liberalisation and environmental protection are important for social welfare and not necessarily mutually exclusive objectives.[6]

Conflicting trade-environment concerns are especially evident in relation to process and product standards.[7] Supporters of free trade, for instance, fear that product standards may act as trade barriers and hamper market access; whereas environmentalists fear that the market access commitments in pursuance of trade liberalisation may trump environmental product standards. A second set of concerns relates to competitiveness. In accordance with this argument the differences in relation to process standards may result in a downward pressure on environmental norms as investors would increase competitiveness by relocating to "pollution havens".[8] The latter argument rests on three assumptions:

- States want to attract investments and prevent capital from leaving;
- Investment capital will be channelled to regions with a competitive advantage;[9] and
- Weak environmental standards represent a decisive competitive advantage.[10]

The first assumption is indeed correct. The second assumption is, however, defendable. Not every kind of business can relocate to any region it sees fit. Various factors may influence the decision to relocate. The third assumption is the weakest. Empirical proof doesn't support the hypothesis. Howse and Trebilcock also disagree with the third assumption. They opine that other responses to these competitive pressures are more

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[5] See D. I. Stern, *The Environmental Kuznets Curve*, in J. L. R. Proops and P. Safonov (eds.), *Modelling in Ecological Economics* (Edward Elgar Publishing, Cheltenham 2005). Arik Levinson, *The Ups and Downs of the Environmental Kuznets Curve* (Paper presented at the UCF/CentER Conference on Environment, 30 November-2 December 2000, Orlando) http://www9.georgetown.edu/faculty/aml6/pdfs&zips/ups%20and%20downs.pdf accessed 6 August 2007. Levinson, however, points out that the pollution does not necessarily always increase with economic growth.

[6] See D. C. Esty, *Greening the GATT: Trade, Environment, and the Future* (Washington, 1994), 226.

[7] It is not the intent of the author to discuss this issue in great depth as this has been done by other scholars. See Esty and Gerardin (n1) 543.

[8] This issue has been debated in the context of American federalism. See: R. L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race to the Bottom" Rationale for Federal Environmental Regulation* (1992) 67 *New York University Law Review* 1210 *et seq;* R. L. Revesz, *The Race to the Bottom and Federal Environmental Regulation: A Response to Critics* (1997-1998) 82 *Minnesota Law Review* 535 *et seq*; and K. H. Engel, *State Environmental Standard-Setting: Is there a "Race" and is it "To the Bottom"?* (1996-1997) 48 *Hastings Law Journal* 271 *et seq*.

[9] See M. E. Porter, *On Competition* (Boston, 1998), 322 *et seq*.

[10] See Johnson and Beaulieu (n3).

viable, such as investment in environmental friendly technologies that can reduce the costs of compliance with environmental standards.[11]

The "competition of systems"[12] paradigm provides an explanation for the concerns pertaining to the trade-environment debate. The "competition of systems" among states is a result of the extension of the competition among business enterprises on an international scale. The extension occurs through trade liberalisation, which dismantles government imposed trade barriers. The concern therefore exists that in the competition for investment capital, states may offer investors lax environmental standards in order to induce investment. It must, however, be borne in mind that in terms of the "competition of systems" paradigm, states remain free to pursue a variety of policy goals, such as sustainable development, which may address the concerns of "environmentalists".[13] Harmonisation of environmental standards is, for instance, viewed as one of the appropriate responses to concerns of market access and competitiveness.[14] Further, some degree of harmonisation of laws and policies at a regional level is in general perceived as a prerequisite for enhancing economic growth and competitiveness in a global world.[15] Harmonisation of environmental standards may result in various advantages. It may, for instance, reduce the administrative and related costs of compliance as firms who operate across borders have to comply with one set of uniform standards. Harmonised environmental standards may also serve as an incentive for the development and production of environmental technologies. The actions of regional regimes illustrate the importance of harmonisation. The European Union serves as the best example in this regard.[16]

It is, however, important to remember that the international plane is characterised by diverging states with different levels of economic development.[17] This means that harmonisation does not always occur between equal partners. Three examples of asymmetry may be of relevance for the purpose of this chapter. Harmonisation may occur between developing and developed states (at the international level through international treaties), between developed states (such as is the case between European states in the

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11 R. Howse and M. J. Trebilcock, *The Free Trade-Fair Trade Debate: Trade, Labor, and the Environment,* in J. S. Bhandari and A. O. Sykes (eds.), *Economic Dimensions in International Law: Comparative and Empirical Perspectives* (Cambridge University Press, Cambridge 1997), 224-30.

12 See for instance H-W. Sinn, *The New Systems Competition* (Malden, 2003). The global markets leave states in a competition against each other for investment.

13 K. M. Meessen, *Economic Law in Globalizing Markets* (The Hague, 2004), 11-12.

14 See Johnson and Beaulieu (n3) 47; and Esty and Geradin (n1) 550. Free traders sometimes oppose harmonisation of environmental standards as they opine that this may result in less efficient domestic regulation. See Howse and Trebilcock (n11) 231.

15 K. Jacob, *Lead Markets for Environmental Innovations* (Heidelberg, 2005), 24-26.

16 See P. G. G. Davies, *European Union Environmental Law: An Introduction to Key Selected Issues* (Aldershot, 2004), 67 *et seq*. See also D. Gerardin, *The European Community: Environmental Issues in an Integrated Market,* in R. H. Steinberg (ed.), *The Greening of Trade Law: International Trade Organizations and Environmental Issues* (Rowman & Littlefield, Oxford 2002), 117-54.

17 International law does not endorse material equality, but formal (sovereign) equality. G. Simpson, *Great Powers and Outlaw States: Unequal Sovereigns in the International Legal Order* (Cambridge, 2004), 26 *et seq*. Art 4(a) establishes sovereign equality as one of the principles of the South African Development Corporation (SADC).

EU)[18] or between developing states (in the instance of the South African Development Corporation).[19]

The occurrence of asymmetry between states may complicate harmonisation, because weaker states may not have the capacity to participate in the development and implementation of environmental standards.[20] These states face urgent social problems. In general, the trend is to harmonise upward, which implies that poorer states are encumbered with an uneven burden. The richer states do not have to make major adjustments in order to comply with the harmonised standards. Poorer states may accordingly perceive the harmonisation process as a form of imperialism[21] and/or protectionism.[22] Where harmonisation results in a state having to comply with environmental standards that are different from the optimal domestic policy outcome for that state, the latter state may even have to sacrifice some of its local welfare.[23]

The South African Development Community (SADC) presents a good opportunity to dissect the issue of harmonisation between unequal states. These states represent some of the poorest states in the world and face various challenges. South Africa, however, overshadows other states south of the Sahara as it portrays a higher degree of development.

It is accordingly the main aim of this chapter to reflect on the issue of environmental harmonisation between Member States of SADC in order to illustrate the issue of asymmetry. The first part of this article briefly introduces SADC and its history and further alludes to the various references relating to the objective to harmonise environmental legislation and policy in the Southern African region. Second, the challenges, which may impair harmonisation, receive attention. As this contribution deals with harmonisation between unequal states, the issue of asymmetry therefore receives special attention. In the third part the author generates proposals in order to address the problems presented. The author concludes the article with brief remarks.

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18 See A. Weale, *Environmental Governance in the European Union: An Ever Closer Ecological Union* (Oxford, 2000), 468-85.

19 It may also be an issue in the context of federalism, but this issue falls outside the ambit of this chapter.

20 Johnson and Beaulieu (n3) 47 *et seq*.

21 See M. Rauscher, *International Trade, Factor Movements, and the Environment* (Oxford, 1997), 296.

22 See J. N. Bhagwati, *Fair trade, reciprocity and harmonization*, in D. Salvatore (ed.), *Protectionism and World Welfare* (Cambridge University Press, Cambridge 1993), 47.

23 See in this instance: A. I. Ogus, *Regulation: Legal Form and Economic Theory* (Hart Publishing, Oxford 2004), 168 and 169.

B. SADC[24] and harmonisation

The Southern African region is plagued by various problems, such as underdevelopment, poverty, HIV/AIDS, illiteracy and malnutrition.[25] A great need exists for the development of SADC countries. Regional economic integration[26] may serve as a vehicle for enhancing economic and social development of African countries.[27] SADC is an example of a regional organisation, which may foster integration in the sub-Saharan region. SADC was established through the Windhoek Treaty.[28] The Member States are Angola, Botswana, the Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe. It is the main objective of SADC to establish a Free Trade Area in 2008. The ultimate goal of Member States is a full economic union with integrated monetary and fiscal systems as well as a regional parliament by 2034.[29]

Member States of SADC acknowledge the importance of trade liberalisation[30] and seem to accept that trade does not need to be detrimental to the environment. They have opted for the mitigation of the negative effects of trade through instruments that address environmental concerns. Member States realise that deeper economic integra-

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24 The predecessor of SADC was the Southern African Development Coordination Conference (SADCC). The SADCC was established in Lusaka, Zambia on 1 April 1980. See SADC, *History, Evolution and Current Status*, http://www.sadc.int/about_sadc/history.php accessed 20 March 2008.

25 See in this regard: S. Naidu and B. Roberts, *Confronting the region: A profile of Southern Africa* (Cape Town, 2004), 47.

26 Integration refers to a process where the economies of states are merged into a regional economy. R. Davies, *The Case for Economic Integration in Southern Africa*, in P. H. Baker, A L. Boraine and W. Krafchik (eds.), *South Africa and the World Economy in the 1990s* (Cape Town, New Africa Books 1993), 217. See also M. Lundahl, *Economic Integration*, in *Globalization and the Southern African Economies* (Nordic Africa Institute, Uppsala 2004); and L. Petersson, *Efforts in Southern Africa*, in M. Lundahl (ed.), *Globalization and the Southern African Economies* (Nordic Africa Institute, Uppsala 2004), 92. Several scholars are, however, pessimistic about the accrual of advantages in the instance of integration between states, which have different development levels. See the discussion of A. Smith, *The Principles and Practice of Regional Economic Integration*, in V. Cable and D. Henderson (eds.), *Trade Blocs? The Future of Regional Integration* (The Royal Institute of International Affairs, London 1994), 17 *et seq*.

27 M. Ndulo, *The Need for Harmonization of Trade Laws in SADC* (1996) 4 *African Yearbook of International Law* 195, 222.

28 Declaration and Treaty Establishing the Southern African Development Community, 1992. The treaty was subsequently amended in 2001. See SADC, *Consolidated Text of the Treaty of the Southern African Development Community, as amended* http://www.sadc.int/key_ documents/treaties/sadc_treaty_amended.php accessed 20 March 2008.

29 See the SADC Protocol on Trade, 2000. See, however, M. Holden, *Southern African Economic Integration*, in P. Lloyd and C. Milner (eds.), *The World Economy: Global Trade Policy 1998* (Blackwell Publishing, Oxford 1998). She is of the opinion that the protocol shall impose more costs than benefits.

30 See B. Chigara, *Trade liberalization: Savior or scourge of SADC economies?* (2001-2002) 10 *Miami International and Comparative Law Review* 7, 9.

tion requires coordination in other spheres, such as the environment. It is therefore that several instruments refer to the importance of environmental harmonisation.

The Treaty establishes harmonisation as an objective of SADC. Article 5(1) of the SADC Treaty, for instance, affirms that it is the aims of SADC to: pursue development and economic growth;[31] complementarity between national and regional strategies and programs;[32] as well as the sustainable use of natural resources and the effective protection of the environment.[33] In order to achieve the objectives set out in Article 5(1), the SADC shall: harmonise political and socio-economic policies;[34] develop policies aimed at elimination of obstacles to the free movement of capital, labour, goods and services;[35] and furthermore develop such other activities as Member States may decide in the furtherance of the objectives of this treaty.[36] Article 21[37] also alludes to harmonisation. It includes the areas of cooperation between Member States. Article 21(2) states that all Member States shall, through appropriate institutions of SADC, coordinate, rationalise and harmonise their overall macro-economic policies and strategies. One of the agreed areas of cooperation is "natural resources and environment".[38] The Secretariat[39] is responsible for the harmonisation of the policies of Member States and the submission of harmonised policies and programs to the Council[40] for consideration and approval.

The Regional Indicative Strategic Development Plan (RISDP) is also of relevance. Institutional difficulties lead to the adoption of a Report on the Restructuring of SADC Institutions.[41] In accordance with the Report, a Regional Indicative Strategic Development Plan (RISDP) has been developed in order to provide strategic direction to SADC.[42] The restructuring process has restructured the previous coordinating units into four directorates: (i) Trade, Industry, Finance and Investment (TIFI); (ii) Infrastructure

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31 Sub-art (a).

32 Sub-art (e).

33 Sub-art (g).

34 Art 5(2)(a).

35 Sub-art (d).

36 Sub-art (j).

37 Art 21(1) reads that "Member States shall cooperate in all areas necessary to foster regional development and integration on the basis of balance, equity and mutual benefit."

38 Art 21(3)(f).

39 Art 14(1)(f) and (h). The Secretariat is the principle executive institution of SADC.

40 See Art 11. The Council consists of one Minister from each Member State and it is one of the responsibilities of this organ to oversee the implementation of the policies of SADC. Other principal institutions include: The Troika, which aims to enhance the institution's ability to execute and implement decisions expeditiously. The Organ on Politics, Defence and Security is responsible for promoting peace and security. The Standing Committee of Senior Officials serves as a technical advisory committee to the Council. It is the task of the Tribunal to adjudicate disputes. The Integrated Committee of Ministers must ensure the smooth implementation of policy and the coordination of cross-sectoral activities. The SADC National Committees provide input into and coordinate regional policies, strategies, programs of action and their implementation at national level. See ch 5 of the Treaty.

41 The Summit adopted the report on 9 March 2001. See SADC, *Restructuring of SADC Institutions* http://www.sadc.int/english/about/structure/restructure.php accessed 12 February 2008.

42 See SADC, *Regional Indicative Strategic Development Plan (RISDP): Downloads* http://www.sadc.int/key_documents/risdp/index.php accessed 12 February 2008.

and Services; (iii) Food, Agriculture and Natural Resources (FANR); and (iv) Social and Human Development and Special Programmes (SHDSP).[43] It is the main aim of the RISDP to provide policy direction over the long term for the Member States. The Plan includes a selection of "intervention areas". The areas discussed in chapter 4 are based on their contribution to the overarching objectives and priorities identified in the Report of the Review of SADC Institutions.[44] "Environment and Sustainable Development" is designated as a priority area.[45] The overall goal of the environmental intervention is to "ensure the equitable and sustainable use of the environment and natural resources for the benefit of present and future generations".[46]

> Paragraph 7.3 accordingly establishes the areas of focus as *inter alia*:
> Creating the requisite harmonised policy environment, as well as legal and regulatory frameworks to promote regional cooperation on all issues relating to environment and natural resources management including trans-boundary ecosystems; promoting environmental mainstreaming and capacity building, information sharing and awareness creation (…)

Paragraph 4.7.4 explicitly affirms the importance of harmonisation as part of a strategy to further sustainable development.[47] This paragraph also includes concrete targets, but these commitments seem to be overambitious and difficult to meet.[48]

Further, Article 22 of the SADC Treaty determines that Member States shall conclude Protocols as may be necessary in each area of cooperation. The Protocols shall determine the objectives and scope of, and institutional mechanisms for, cooperation and integration. Various protocols, dealing directly or indirectly, with environmental issues have been concluded.[49] These Protocols also contain several references to the objective of harmonisation. One example in this regard is the Protocol on Wildlife Conservation and Law Enforcement of 1999.[50] It is the primary objective of the protocol to establish

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43 See SADC, *Social and Human Development & Special Programmes (SHD&SP)* http://www.sadc.int/shdsp/index.php accessed 20 March 2008. The FANR is mainly responsible for environmental protection. Other directorates, however, also deal with environmental matters due to the cross-sectoral nature of the matter.

44 Ch 4, para 1. As approved by SADC Heads of State and Government in Windhoek, Namibia in March 2001.

45 Ch 4, para 7.

46 Ch 4, para 7.2.

47 The strategies include: "the harmonization of National Environmental Policies and legal frameworks, the development of a harmonized environmental information system and the harmonization of positions and coordination of regional efforts to ensure maximum benefit for SADC member states in all MEAs".

48 According to the targets the "[l]egal instrument for regional cooperation in environment and natural resources" had to be finalised by 2006. This target has not been met. The Protocol on Forestry has, for instance, not been ratified. It also states that the principles of sustainable development must be integrated into country policies and programs by 2015.

49 See for instance the Protocol on Energy of 1996; Protocol on Fisheries of 2001; Protocol on Forestry of 2002; and Protocol on Shared Watercourse Systems of 1995 and the revised Protocol of 2000.

50 This Protocol entered into force on 30 November 2003.

common approaches to conservation and sustainable use of wildlife.[51] It is one of the objectives of the Protocol to harmonise legal instruments governing wildlife use and conservation.[52] Member States accordingly have an obligation to guarantee the conservation and sustainable use of wildlife.[53] Parties therefore shall –

> (…) endeavour to harmonise national legal instruments governing the conservation and sustainable use of wildlife; such harmonisation shall include but not be limited to standardizing.[54]

Furthermore, Article 10 makes provision for capacity building to ensure effective wildlife management. The Member States are obliged to establish a Wildlife Conservation Fund to finance projects associated.[55] It is evident that the Protocol does not stipulate the instruments or manner through which harmonisation should take place.[56] It merely creates, in conjunction with the Treaty, the legal basis for harmonisation.

C. Asymmetry in the Southern African region

SADC consists of developing and least developed states. Asymmetry between the various states is evident.[57] The South African economy is larger than the combined economies of the other SADC members.[58] Member States are dependent on South Africa for their imports of goods. South African GDP constitutes 65,7 % of the total SADC GDP.[59] This illustrates the enormous difference between South Africa and the other SADC states.

In addition South Africa has a very modern and progressive environmental framework.[60] It might therefore be possible for South Africa to pursue harmonisation in accordance with its legislation.

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51 Art 4(1).

52 Art 4(2)(b).

53 Art 6(1).

54 Art 6(2).

55 Art 11.

56 This is also the case with the other Protocols.

57 This illustrates that "developing states" do not constitute a homogenous group, but consists of a group that adheres to certain criteria of underdevelopment. A low level of GDP mostly is an important indicator of the poor economic growth of developing countries. See M. Bulajić, *Principles of International Development Law: Progressive Development of the Principles of International Law Relating to the New International Economic Order* (2nd rev edn Nijhoff Publishers, Dordrecht 1993), 168.

58 See N. C. Weggoro, *Effects of a Regional Economic Integration in Southern Africa and the Role of the Republic of South Africa: A Study of Project Coordination Approach in Industry and Trade in SADCC/SADC* (Köster, Berlin 1995), 202.

59 See SADC, *Regional Indicative Strategic Development Plan (RISDP) Chapter 2: Socio-Economic Situation in SADC* http://www.sadc.int/english/documents/risdp/chapter2.php accessed 20 March 2008.

60 See for instance National Environmental Management Act 107 of 1998 (SA). Although South African legislation may be progressive, difficulties regarding enforcement exist. See for a discus-

Furthermore, one should view the asymmetry between SADC states in the context of certain important facts in order to gain a clear understanding of the issue.[61] SADC members exhibit a lack of commitment to real integration. These states still cling to nationalism and pursue short-sighted self-interest, which may be detrimental to the interests of SADC as a whole. Traditional rivalry between states still thrives. SADC states face several problems, such as poverty, malnutrition and HIV/AIDS. The Southern region is also plagued by civil wars and unstable governments, such as is the case in the Democratic Republic of the Congo and Zimbabwe. Furthermore, SADC integration is also hampered by institutional challenges.

D. Proposals[62]

It is obvious to propose that South Africa should not use its dominant position to pursue harmonisation on the basis of protectionism. This will have a very negative influence on the integration and harmonisation process in the region. Weaker states would be very suspicious of any attempts to harmonise environmental legislation. Domestic pressure may, however, induce South Africa to pursue self-interest, which may not be to the advantage of SADC.[63] It therefore seems that some radical paradigm shift is required so as to ensure that much needed economic growth is achieved, without jeopardising the environment.

The principle of solidarity, as incorporated in Article 4(b) of the SADC Treaty may present an alternative to the pursuit of mere self-interest and may accordingly introduce a paradigm shift. In terms of the principle of solidarity[64] SADC States should not take into consideration only their own interests in shaping their international interests but also those of other members or the interests of the community, or both. South Africa should

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sion: C. Loots, *Making Environmental Law Effective* (1994) South African Journal of Environmental Law and Policy 17-34.

61 See the discussion of Ndulo (n27) 208-213.

62 It is not the objective of this discussion to question the option of SADC to harmonise as it would fall outside of the ambit of this discussion. Other responses to trade and environment concerns, however, exist. See also J. A. Soloway, *The North American Free Trade Agreement: Alternative Models of Managing Trade and Environment*, in R. H. Steinberg (ed.), *The Greening of Trade Law: International Trade Organizations and Environmental Issues* (Rowman & Littlefield, Oxford 2002), 155-88.

63 The traditional conduct of states reflects the pursuit of national interests and the preservation of nation-state autonomy is in general more important than the prevention of environmental degradation. P. Allott, *International Law and International Revolution: Reconceiving the World* (Josephine Onoh Memorial Lecture, Hull University Press, Hull 1989), 8; and A. D. Tarlock, *The Role of Non-Governmental Organizations in the Development of International Environmental Law*, (1992-1993) 68 *Chicago Kent Law Review* 61, 62.

64 R. St. J. Macdonald, *Solidarity in the Practice and Discourse of Public International Law,* (1995) 8 *Pace International Law Review* 259 et seq; and R. Wolfrum, *Solidarity amongst States: An Emerging Structural Principle of International Law*, in P.-M. Dupuy and others (eds.), *Völkerrecht als Wertordnung: Festschrift für Christian Tomuschat* (N. P. Engel Verlag, Kehl 2006), 1087-1101. Solidarity is seen as an unenforceable moral standard.

in assistance with the other members aim to ameliorate existing inequalities. This implies that in pursuing the common goal of sustainable development, South Africa, may have to contribute more than others in meeting common obligations. In this regard cooperation is of importance.[65] Cooperation actually gives effect to solidarity.[66] A characteristic of cooperation is that states aim to achieve common ends. This means that all SADC states should communicate in order to pursue sustainable development. Furthermore, differential treatment may be regarded as a practical application of solidarity.[67] Differential treatment allows for non-reciprocal arrangements that aim to promote substantive equality.[68] The question accordingly arises whether differential treatment could also be applicable between developing countries (or developing and least developed countries) in the SADC context? It is not unthinkable that Member States of the SADC regime envisage certain forms of differential treatment in order to address the asymmetry. Several provisions incorporated in important documents may provide guidance in this regard. The RISDP seems to take cognisance of the asymmetry between states.[69] It allows for differential treatment of less developed states. In this regard the Common but differentiated Responsibilities principle[70] may provide guidance concerning the interpretation and implementation of SADC obligations as well as the negotiation of future instruments.

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65 R. Wolfrum, *International Law of Cooperation,* in R. Bernhardt (ed.), *Encyclopedia of Public International Law* (Springer, Berlin 1995), 1242-247.

66 Ch 7 of the Treaty deals with cooperation.

67 P. Cullet, *Differential Treatment in International Environmental Law* (Brookefield, 2003), 44.

68 Cullet defines differential treatment "as the instances where the principle of sovereign equality is sidelined to accommodate extraneous factors, such as divergences in levels of economic development or unequal capacities to tackle a given problem". P. Cullet, *Differential Treatment in International Law: Towards a New Paradigm of Inter-state Relations* (1999) 10 *European Journal of International Law* 549, 551. This principle has been revitalised in the field of international environmental law and is in general applicable to the relationship between developed and developing countries.

69 Para 4.10 is titled "Trade, Economic Liberalization and Development". It states that: "The policies and strategies that are adopted for trade, industry, finance and investment should take into consideration the special needs of less developed member countries and ensure that a win-win situation prevails. In the case of the trade protocol, the principle of asymmetry was adopted to address the concerns of less developed member countries in terms of tariff reduction and also on rules of origin for some products, which were made less stringent for them, at least in the first three years."

70 M.-C. Cordonier Segger and others, *Prospects for Principles of International Sustainable Development Law after the WSSD: Common but Differentiated Responsibilities, Precaution and Participation* (2003) 12 *Review of European Community and International Environmental Law* 54 et seq.

E. Choosing the most suitable harmonisation strategy

The principle of solidarity may inform the choice of harmonisation techniques, which are to be applied in the SADC region.[71] Different harmonisation strategies may be distinguished.[72] Strategies which are most suitable to address market access concerns are total harmonisation,[73] maximum standards harmonisation,[74] essential requirements harmonisation,[75] pre-standard harmonisation[76] and public information harmonisation.[77] The techniques most appropriate for competitiveness concerns are minimum standards,[78] multi-tier harmonisation,[79] convergence harmonisation,[80] differentiated harmonisation,[81] goal harmonisation,[82] harmonisation of options,[83] and systems harmonisation.[84]

In the context of the present discussion it is my opinion that solidarity may guide policymakers to opt for multi-tier and differential harmonisation.[85] This means that solidarity may be made concrete through differential treatment between states. In accordance with the principle of solidarity SADC states will focus their efforts on a common goal in order to ameliorate the existing inequalities between states. The common objective is sustainable development. This implies that these states will pursue development, which could alleviate poverty. The development sought should, however, meet the needs of present generations without compromising the ability of future generations to meet their own needs.[86] This common objective can only be aspired to through cooperation. The existing inequalities between Member States, however, dictate that not all states are able to

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71 It is not the purpose of this article to propose the instruments that should achieve harmonisation. It is, however, not unthinkable that directives may be used to facilitate harmonisation.

72 Esty and Geradin (n1) 550-51.

73 In this instance all states adopt uniform product standards.

74 This implies that states may choose to adopt less stringent standards.

75 Harmonisation is limited to essential requirements and the regulation of the technical regulations to achieve the basic requirements is left to individual states.

76 This entails that states use common testing protocols, scientific methodologies and risk assessment procedures.

77 An example of this is the usage of an eco-labeling scheme.

78 In this instance minimum production process standards are established. Regulatory authorities may therefore set higher standards.

79 Different standards are set for different groups of states. One of the most important factors determining the level of environmental protection is a state's level of economic development.

80 This technique entails a negotiated convergence of standards.

81 In terms of this approach a central authority establishes targets, but provides for different degrees of stringency in accordance with the circumstances in the different states.

82 In terms of this strategy states choose environmental means to achieve the established goals.

83 States are hereby given a range of policy options from which to choose.

84 This implies that states have to conform to specified environmental systems, such as ISO 14000.

85 This is not to say that other techniques are not of relevance. It is furthermore clear that overlap exists between the different harmonisation techniques. It is, however, important to ensure that harmonisation should take into account the different levels of economic development between states as well as, for instance, geographical differences.

86 G. Bruntland (ed.), *Our Common Future: The World Commission on Environment and Development* (Oxford, 1987).

contribute to the same extent to pursue the common objective. It is in this regard that multi-tier and differential harmonisation techniques could prove useful to address the asymmetry that exists between SADC states.[87] The latter form of harmonisation takes cognisance of the Kuznets curve as poor states are not overburdened with overambitious standards. Multi-tier and differential harmonisation could benefit Southern African states as it could create networks and the sharing of information and technology. It may further prove useful to address transboundary pollution.[88] South Africa may also assist in the building of capacity in the other states. A phased approach may ensure that states progress to higher degrees of environmental protection. This harmonisation effect would also provide for economies of scale. This proposal implies that South Africa will have to take the lead and initially adhere to stricter environmental standards. The mere fact that South Africa may be required to comply with higher standards does not need to be to the detriment of this state. Stringent standards may serve as an incentive to invest in environmental friendly technology, which may provide South Africa with a competitive advantage.[89] Ultimately in accordance with this opinion stringent environmental standards thus may have a desirable effect on domestic welfare.[90] In addition the whole region will benefit from the collective, albeit differential, effort of the Member States. In this manner states may pursue a common goal without attempting to impose unrealistic standards on weak states.

F. Concluding remarks

The abovementioned discussion implies that South Africa should use its power not to dominate, but to guide and assist states in Southern Africa. The progressive environmental laws of South Africa may serve as an example for other states, but this does not mean that all states will be able to adhere to these standards. Even South Africa still finds it difficult to enforce its own laws. South Africa must take a leading role in the pursuit of sustainable development in SADC. This will mean that South Africa may have to encumber more obligations in order to reach this common goal. This statement, however, does not ignore the fact that South Africa also faces various problems that it needs to address.

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87 Council Directive 88/609 on the limitation of emissions of certain pollutants into the air from large combustion plants serves as a good example of a multi-tier directive. See 1998 OJ L 336/1, replaced by 2001 OJ L 309/1.

88 One of the useful mechanisms in this regard may be to provide for more uniform Environmental Impact Assessments.

89 This implies that South Africa may "export" environmental friendly technology when other states are ripe to comply with more stringent standards.

90 The link between environmental regulation and competitiveness is, however, a complex issue. R. Jenkins, *Environmental Regulation, International Competitiveness and the Location of Industry*, in R. Jenkins and others (eds.), *Environmental Regulation in the New Global Economy the Impact on Industry and Competitiveness* (Edward Elgar Publishing, Northampton 2002).

It is however clear that is only through true integration that SADC will be able to foster regional good governance,[91] sustainable development and accordingly poverty alleviation – and South Africa is the Southern African giant that needs to facilitate this much needed change.

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[91] See K. Ginther, E. Denters and PJIM de Waart (eds.), *Sustainable Development and Good Governance* (Dordrecht, 1995).

Harmonization of Business Law in the Maghreb: Legal Obstacles and Opportunities

Said Ihrai[*]

Introduction

One week after the meeting of the monitoring committee of the Arab Maghreb Union (AMU), the Foreign Ministers of the Organization, at a meeting in Rabat on 11 and 12 December 2003, reaffirmed Member States to relaunch the consultation process within the AMU.

The Organization Maghreb seems again ready to restart it after a standstill which has lasted more than ten years and affected its principal organs. During the few years when it functioned normally, the organization failed to consolidate the Maghreb integration process. Nevertheless it served as a framework for coordination among the member states.

In connection with the issue of harmonization of business law, it seems extremely important that the legal framework within the AMU is again put in use by the Maghreb states. The mechanisms thus established may complete the process of consultation and reflection initiated after the states of the Maghreb gained their independence.

The regional and international situation seems indeed conducive to the resumption of the dialogue within the Maghreb. A series of international events recently strengthened and consolidated the opening of the economies and political systems in the region. In addition to the acceleration and the extension of the effects of globalization and their impact on the societies of the Maghreb, the American initiative for a Greater Middle East, the emergence of the first signs of a "Maghreb particularism" in the Arab world, and the intention of the EU to distinguish itself from the policy pursued by the USA in the region, are all factors that promote the reintegration of AMU in its regional and international environment.

The EU action is in particular developing through the reactivation of the Barcelona process launched in 1995 but also through the growth and the reorientation of European aid to prepare the Maghreb economies for the establishment the Euro-Mediterranean free trade area in 2012.

The lifting of the embargo imposed on Libya and its integration into regional diplomacy as well as the participation of other states of the Maghreb in NATO consultations and in manoeuvres organized by the Atlantic Alliance are all elements indicating significant changes in the political but also economic choices of the Maghreb states. In fact, one notices that the economic and social partners in the five countries are consolidating their standing vis-à-vis the State as the private economic sector and civil society

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are trying to escape political guidance. Thus the economies of Algeria and Libya are gradually liberalizing, and the private sector, for a long time marginalized and sometimes even suppressed, is now being encouraged and supported.

We perfectly understand that the harmonization of business law is well advanced in the EU, but how can we explain the fact that the process of harmonization of business law has begun within the OHADA, an organization of 16 states in sub-Saharan Africa of which 12 belong to the category of LDCs? Is the harmonization of standards a purely voluntary legal phenomenon depending on the will of its initiators? Or does it, on the contrary, require the prior existence of objective factors related to the level of development of the respective states and the state of their business law legislation.

It seems that, to be effective, the harmonization of business law requires a level of economic activity and business opportunities among the countries involved in this operation. From this point of view, the Maghreb currently enjoys national and international conditions conducive to economic harmonization of the laws of the member states.

Indeed, the Maghreb economies are rapidly liberalizing. Everywhere the public sector is being dismantled and the State is gradually withdrawing from all areas where privatization is considered of no harm to the general interest. The private sector is promoted by the Maghreb states and business opportunities are eagerly sought through the establishment of free trade areas with different trading partners. The promotion and protection of private investment nationally and internationally is henceforth assured through the development and implementation of highly favourable laws and regulations.

But barriers related to the cultural environment in the Maghreb, the obstacles resulting from an informal sector in the amount of 30 to 40 % of GDP of the Maghreb states and from the complexity, diversity and the age of the existing rules of law reflect an often inadequate standard of Maghreb law and impede the harmonization of business law in the Maghreb. Attempts of harmonization have been put in place both within and outside the AMU. The modest results achieved so far prompts to put forward a few suggestions.

A. National and international conditions favouring the harmonization of business law

The economies of the Maghreb are being liberalized. That development, though a recent phenomenon in Algeria and Libya, dates back in Tunisia and Morocco to the eighties of the last century. Such policy of economic openness was adopted by both countries since their respective independence in the late fifties. That option, however, goes along in both countries with a strong and important public sector.

The accelerated pace of globalization following the implementation of the charter of the WTO/GATT of 1994 as well as the global policy of the USA in some cases accelerated, and in others triggered, the opening of the Maghreb economies.

In those countries, the State has become an economic partner seeking to implement, and comply with, the rules on competition, transparency and the rules requiring the promotion and protection of private cross-border investment. To accompany all these measures, a legal framework truly conducive to the development of trade in the Maghreb is being established.

I. The growing of the opening economic systems: from the rule of law in general to economic law

One is struck by the magnitude of the trend of normalization affecting the economic and political systems in the Maghreb. The political pluralism and electoral frenzy experienced by Maghreb society is matched by the restructuring of development policy resulting from the dismantling of the public sector. In that process of catching up, legal rules play an important role. Countries of the Maghreb seek, and in fact simultaneously put forward, both the democratization of their political systems and the liberalization of their economies.

In an effort to become a real economic partner, the State, in the most open countries of the Maghreb, adopts procedures of advanced liberal countries and arranges for service contracts with an increasingly active private sector in an increasingly transparent way. Thus the state is led to agree on contract programs with partners from the private sector in areas where the government has proved inefficient. This redeployment of government action force the government to improve its management methods, and streamline to a certain extent, government spending. By way of contract programs, the government and the private sector, in a specific area avoiding any unreasonable clauses of law, undertake to implement a program aimed at strengthening the respective economic activity. This new method of government action recently made its appearance in Morocco with regard to tourism and the textile sector, two areas where both domestic and foreign private investment is solicited.

This new ways of doing things in the economic sphere, of course, requires new rules for the awarding of public contracts. The new legislation opens markets of this type to free competition and establishes procedures to ensure a maximum of transparency.

The public sector, mismanaged and often in deficit, was dismantled in favour of private initiative. Thus privatization is being put in place in the Maghreb. Algeria and Libya have in turn recently taken important steps towards privatization. Many public enterprises are being sold to domestic and foreign private sector.

Furthermore, states in the region are encouraged to outsource the management of certain activities they exercised before or had entrusted to local communities, to foreign private companies. Thus the management of water and electricity, transport, sanitation, solid and liquid, are now operated by foreign private companies. This particularly is the case in Morocco.

In the view of Maghreb lawyers, the notion of public service mission, borrowed from French administrative law is subject to an unprecedented process of transformation. This notion, having to comply with the requirements of globalization, sees its scope shrink dramatically.

It is true that these privatizations are imposed by international financial institutions but they also allow Maghreb states to reduce their budget deficits by eliminating financial grants, which were annually awarded to poorly managed public enterprises of very low profitability.

At the end of the 20th century, an opening of the political and economic systems in the Maghreb can be observed. This opening, which is increasingly extended, certainly encourages the harmonization of business law in these countries as well as the adoption of legislation in these states designed to protect and promote the international private investment.

II. The protection and promotion of the law of the international private investment in the Maghreb

Public and private investments in the Maghreb by Maghreb investors are very modest. The figures available to us concern the development of Libyan investments in Morocco. They amounted to 22.3 million dirhams (US$ 1 was equal to 10 dirhams roughly), equivalent to 2.23 million US dollars, before collapsing to 0.22 million dollars in 1999 with the exception of strong increases in 1991 (39.7 million US dollars) and in 1997[1] (24.35 million).

1. The issue relating to the extension of the current general legal regime to the maghrebi investor

Only two countries, Morocco and Tunisia, are parties to the New York Convention of 1958 on the enforcement of foreign judgments in the states parties, on the one hand, and to the Washington Convention of March 18, 1965 , on the other. But all the Maghreb states are parties to the Arab Convention for Arbitration in 1974, to the Convention of Amman on Commercial Arbitration, and the AMU Convention on the Protection of Investment in the Maghreb, in force since July 1993. Nothing, however, forbids applying those instruments to Maghreb investment, at least among the respective contracting parties, provided of course that the investment meets the new eligibility criteria set up by the respective Maghreb host state. Thus for example in Morocco, the new criteria related to the creation of stable jobs, to the very advanced nature of the transferred technology, and to environmental protection, have come to support the former relating to the financial significance and the localization of the project. Neither Maghreb states enterprises, nor private investors of the Maghreb meet these conditions. But Maghreb investment, once performed, enjoys all the benefits granted to the foreign investor laid down either in a bilateral agreement for the establishment or in a contract. In case of failure of modes of alternative dispute resolution, both legal instruments provide recourse to international arbitration.

2. The application of the general rules of international arbitration law on investment disputes in the Maghreb

The use of general rules of international arbitration law is another factor liable to promote harmonization of standards in this area. During the 1970s, the overall trend in the Maghreb was to apply national law in the case of litigation related to investment.[2] As soon, however, as the agreement of March 18, 1965 came into force, Morocco and Tunisia adopted positions, which were in a strong minority in developing countries at the time, in favour of internationalization of the investment contract.[3] In the case of

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1 Cf Khalid Moukite, *Le régime juridique des investissements au Maroc* (doctoral thesis, Université Panthéon, Assas Paris II, 2001).

2 See the argumentation of the Libyan government in: TEXACO/CALASIATIC o/Libya, Award of 19 January 1977, para 90, Journal du Droit des Affaires 1977 p. 376 et seq.

3 Moukite, loc.cit.

Morocco, and that observation can be extended to Tunisia, domestic legislation 1974 clearly opted for the application of national law and also of rules of international law with regard to disputes submitted to international arbitration. "This has given the parties and arbitrators the authority to choose not only a national law, but also general principles of law and international trade practices".[4] Although delayed as compared to other Maghreb states, the process of internationalization of contracts began in Algeria in the early 1980s by the Franco-Algerian arbitration rules of 1983, which stipulate that arbitrators apply the law of the place the most characteristic provisions of the contract are related to and that "in all cases, the arbitration panel will take into account the terms of the contract and trade usages."[5] This trend is consolidated in Algeria where contract practice more and more embraces international arbitration in the case of a dispute between the state and the foreign private investor. The accession of Algeria to the ICSID Convention of March 22, 1996 completes the process of internationalization of the international investment contract in that country. So far, four Maghreb countries are members of the ICSID.[6] The Libyan government moves in that direction, and the openness currently registered in that country will not fail to lead, if it is confirmed, to an adherence to international mechanisms for resolving disputes related to investment. The adoption of international mechanisms for the protection and promotion of international private investment in the five states of the Maghreb will lay the foundation for a process of harmonization of standards in this area.

III. A legal framework conducive to the development of trade in the Maghreb

Four legal facts of regional importance are likely to accelerate the establishment of a legal framework conducive to the development of trade in the Maghreb. Regarding Algeria, it is the treaty of association with the European Union signed on April 22, 2002 and the accession to the WTO after the other Maghreb countries. As regards Morocco, the agreement to establish a free trade zone with the USA in 2004 and the Treaty of Agadir are consolidating the opening of markets. There is some momentum, which is likely to lead to a process of economic and political liberation and thereby to the harmonization of business law in the Maghreb.

1. Legal consequences of their accession of the maghrebi states to the WTO

The dismantling of the MFA in January 2005, as well as the phasing out of protective cross-border measures and other restrictive regulations will have immediate and direct impact on the economies of the Maghreb. But these countries still retain the possibility, under Article 24 of GATT/WTO, to be united to free trade zones and customs unions. Maintaining such a provision in the charter of the WTO is certainly intended by the

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4 See Mohammed Bedjaoui and Driss El Karkouri, *L'arbitrage commercial international en droit marocain,* Journal du droit des affaires 2001, p. 71-79.

5 Abdelwahab Bekhechi, *Quelques éléments de réflexion sur la pratique algérienne du contrat", in: contrat international et pays en développement sous direction d'Hervé Cassan* (Paris, Economica, 1989) p. 240.

6 Tunisia and Mauritania since 14/10/1966 and Morocco since 10/06/1967.

negotiators to mitigate the effects of the implementation of the charter for the fragile economies.

Furthermore, the Euro-Mediterranean partnership established by the Barcelona Declaration allows for the establishment of free trade areas between the EU and the contracting States on the one hand and among the contracting States themselves. The EU encourages and supports horizontal arrangements. Maghreb countries will be able to improve their contribution to the institution "of a zone of shared prosperity in the Mediterranean".

2. Legal imperatives of the Euro-Mediterranean partnership

If Libya, on which the Security Council imposed sanctions until 2004, is not a party to the Barcelona Declaration, and if Mauritania is linked to the European Union through the convention ACP States, both countries can, integrate the Barcelona process through the Arab Maghreb Union and through the membership in the Agadir Agreement. This issue concerns both the member states of the AMU and the EU. A conciliation meeting in Paris of January 2004 between the two institutions examined legal and other problems that could possibly integrate Libya and Mauritania into the Barcelona process and the development of bilateral cooperation between the States parties to the Declaration as well as the arrangement of mechanisms for multilateral and bilateral cooperation between the parties.

In connection with the issue of harmonization of business law, it is worth recalling that the three main objectives embodied in the Declaration are: "advancement and regional integration, the establishment of a free trade area, as well as the implementation of an appropriate economic dialogue in the areas concerned." The establishment of a free trade area between the EU and the States Parties shall be reinstated in order to strengthen the legal content in each of the bilateral treaties of association.

The year 2010 was chosen as the deadline for the establishment of the free trade area through the development of "gradual free trade", and the removal of tariff and nontariff barriers to trade in manufactured products. Similarly agricultural trade will be progressively liberalized through the institution of reciprocal preferential access among the parties, as will the service "with due regard to the GATS agreement." The modalities for the establishment of the free trade area set out in the Barcelona Declaration, are "appropriate measures in the areas relating to rules of origin, certification, in terms of competition and the protection of Rights of intellectual and industrial property. " These measures must be part of a comprehensive program based on "the promotion and development of the private sector, upgrading the productive sector and the establishment of an appropriate institutional and regulatory framework for a market economy."

Thus the Barcelona Declaration, on the one hand, and association agreements and measures relating to the implementation of these agreements, on the other, establish the legal framework likely to encourage the harmonization of business law in the three Maghreb countries, Morocco, Algeria and Tunisia. The process, begun in Barcelona in November 1995 whose further reactivation is demanded both in the North of the Mediterranean on its southern flank, has helped launch the Agadir initiative.

3. The creation of a free trade area

The Agadir Declaration aims at establishing a free trade area between the Arab States party to the Barcelona Declaration. It was also a means to overcome the standstill of the AMU, and the failure of the project to create a free trade area in the Maghreb. Once launched, the EU has supported the undertaking, and the conference of Euro-Mediterranean trade ministers held in Palermo on July 7, 2003, welcomed the initiative and invited "Moroccan parties involved to conclude the agreement as soon as possible" and therefore, also recommended "the simplification of customs procedures, in areas related to legislation, administrative cooperation."

A new neighbourhood policy established by the EU in 2003, aims to strengthen relations between the enlarged Europe "with the countries who will be in its new external land and sea borders." It offers the opportunity to "friends of Europe to participate in the domestic market which will ultimately achieve the free movement of persons, goods, services and capital."[7] This new European offer also seeks to encourage regional integration and sub-regional between countries of the southern Mediterranean. The free trade agreement signed between Morocco and Turkey in 2004, fits perfectly into the strategy put in place by the Declaration and the follow-up program in Barcelona. All the measures included in the mechanism for Euro-Mediterranean partnership has, as we have seen, a great potential for the harmonization of business law in the Maghreb. Other legal instruments may in due course support the harmonization process.

4. Legal instruments adopted outside the EU

It is essentially a matter of implementing the free trade zone established in the Arab world and the free trade agreement Morocco/USA.

a) The Arab free trade zone

The provisions of the agreement to establish a "Great Arab Free Trade Area", entered into force on 1 January 2005. Trade between the 17 Arab states parties to the agreement does not exceed 3 % of the total trade of these countries. The reduction of tariffs in this area began in 1998, it reached 80 % in 2004 and the total elimination was announced for January 2005. The Arab free trade zone is based on the principle of Arab origin of products traded as well as of the gradual removal of tariff and non-tariff barriers in the Arab world. The harmonization of customs standards accompanies the process of establishment of the zone, and the economic and social council Arab is responsible for the implementation, by State Parties, of their obligations. The agreement Morocco/USA completes that program.

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7 Letter of the EU Representative in Morocco of October 2003, p. 4.

b) The free trade agreement between Morocco and the USA:

The agreement was signed in Washington on June 15, 2004. It was ratified by the U.S. Congress in November of that year. The agreement has meanwhile also been ratified by Morocco. This is a classic agreement in the matter as it aims to increase the trade between the two countries and, more importantly, to encourage American investment in Morocco. Regarding the harmonization of business law, the agreement will promote the upgrading of the laws and regulations of Morocco on this matter. As noted above, the conditions have become highly favourable for the initiative to the harmonization of business law. But the harmonization process can only succeed if the structural obstacles impeding its implementation have been removed or at least reduced.

B. Persisting structural barriers to the harmonization of business law in the Maghreb

Each of the five Maghreb countries currently has a business law, whose provisions, in at least four of them, are essentially based on French law since France had established a modern economic sector in its former colonies . The case of Libya is different. Private trade having been abolished in the 1980s, business law in Libya essentially is Islamic in the domestic context and Anglo-Saxon with regard to the relations Libya has with the foreign oil companies. The present economic opening suggests the adoption of the rules of a modern corporate law like the one that exists in its Maghreb neighbours and in Egypt. All over the countries of the Maghreb, there remains a problematic relationship between religious standards and modern business law in the informal sector. The importance of this area varies from one country to another. While of some importance in Morocco, Algeria, Libya and Mauritania, its importance undeniably is more restricted in Tunisia. Faced with the modern sector, the informal sector exerts great resistance, and the modern rules of business law have great difficulty in making all the economic activities of Maghreb states subject to the logic of modernity and standards of profitability, legal security and effectiveness.

I. The problem of the relationship between the Islamic and the modern standard in the legal systems of the Maghreb

The economies of the Maghreb are characterized by the co-existence between a modern, dynamic, productive and open export sector and a traditional sector of low profitability mainly oriented towards the domestic market. The economic strategies of the states of the region aim at raising the level of the traditional industries by simultaneously modernizing its structures and management methods. In the traditional sector, which is not entirely identical with the informal sector, the legal standards are of religious nature as religious customs and practices are applied. They are derived from religious law, and there are even residual norms of tribal origin.

1. The elements of the problem

The problem concerns the relationship between international law and domestic law in the Maghreb states. Although Islam is the official religion in all the constitutions of the Maghreb, international law has priority over domestic law, which is only in part of religious origin. Such primacy of international business law, however, is neither displayed nor affirmed, but religious law is everywhere confined to matters of personal status. The other branches of the law, however, are directly inspired by European and, in particular, French legislation. None the less, some fundamentalist currents of thought, while of no influence on the state and even less so on the business in the Maghreb, require compliance of European standards with the principles and norms of religious law. That is how we perceive the relationship between international law and domestic law in Muslim countries, supported by the international organization, which includes all Muslim states, namely the Organization of the Islamic Conference. The problem therefore exists and it has a bearing on the issue of harmonization of business law, an area in which, according to the OIC, Muslim standards are very developed. Nevertheless, in the Maghreb, the standard of modern business nowadays is indifferent to religious law. The territory of each body of rules remains well defined so that none of the Maghreb states have moved into fundamentalism. On the contrary, modern business law tries to incorporate the informal sector into the modern economy of the states of the Maghreb.

2. The integration of traditional sector and attempts to reduce the field of informal

The contribution of the informal sector to the gross domestic product of the countries of the Maghreb varies between 20 and 50%. The lowest figure is recorded in Tunisia. The informal sector escapes taxation, on the one hand, and existing regulations, on the other. It develops outside business law and has its own rules. Thus while retaining strong ties with the regulated sector, it retains a particular position within the countries of the Maghreb insofar as it provides jobs, admittedly fragile but very useful, to a good part of the population of these countries. It has also the advantage of supporting the domestic market. Access to external markets necessarily makes the informal sector switch to the formal sector.[8] The change is accompanied by an insertion in the regulatory sector, a device which, in turn, is expected to take account of the religious element of public order in those Muslim countries.

3. The issue of respect for religious law by the business law of the Maghreb

There is in fact a law of Muslim business: Through a series of resolutions of the Islamic Fiqh Academy – Figh being the science of religious law –, The OIC laid down the broad principles taken directly from the Koran and the traditions of the Prophet. As released by the Academy, this legislation affects the following areas: taxes on religious claims, real estate and the lease of land, insurance and reinsurance, banking transactions involving

[8] Interview with the Minister of Trade and Industry, *L'économiste* (Casablanca) of 20 December 2004.

interest, shares of corporations, bank bills, letters of guarantee, the sale of trademarks, intangible rights etc. Furthermore, in the context of carrying out banking activities, the Islamic Development Bank is complying with "the Islamic sharia." According to the Islamic Fiqh Academy, "there is a consensus among Muslim scholars with regard to banning bank interest and also transactions with regular banks as long as there are Islamic banks in the vicinity". The academy adds, "any award of money must be seen as an investment, a financial contribution that can generate profits in full consistence with the Sharia according to which earning money must result from genuine activity and pecuniary benefit is considered illegal if there is no equivalent service rendered."[9] Aiming at the adoption of the Sharia by Muslim states, the Council of the Islamic Fiqh Academy urges in one of its resolutions "all governments of all Islamic countries to undertake the implementation of the Islamic sharia, and to fully, completely and permanently comply with it in all areas of life. It invites all Muslims, individuals, peoples and states to comply with the requirements of the religion of God and to implement the sharia, Islam providing the creed and the law (sharia), as a form of conduct and lifestyle."[10] Obviously, the resolution of the Academy does not bind the member states of the OIC, in which a very small minority, only three states, subscribed to the sharia as a form of governance and management of public and private affairs. None of the five states of the Maghreb has an Islamic government. Maghreb countries, in fact, refuse being forced to choose between open rupture with Islamic law or the total adoption of the sharia. Like other branches of Maghreb positive law, business law is brought into line with international conventions duly ratified by them. This is true of commercial law, criminal law, banking law, accounting law, law of international investment, diplomatic law etc. The sharia, in all the countries looked at remains as was said before a matter of personal status. Thus no government of the Maghreb, Libya included, subscribed to the fundamentalist logic despite the many pressures, often armed, exerted by movements who, according to a formula of a Moroccan leader do not want to "modernize Islam," but to "islamize modernity."[11] The harmonization of business law in the Maghreb, consists of an upgrading of the standards of this branch of law in order to make them conform with WTO and EU rules. The other obstacles to the harmonization process lie in the very complexity and age of existing business law.

II. The difficulties related to the complexity and the age of the rule of existing business law

In the four areas of business law concerning real estate, taxation, labour relations and the protection of intellectual property and trade, harmonization has to cope with the complexity and obsolescence of existing standards in the countries of the Maghreb.

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9 Rachid Bel Hassan Alaoui, *L'OCI, étude d'une organisation internationale spécifique* (doctoral thesis, Université de Bordeaux IV) at p. 289.

10 Resolution No. 10, Académie islamique du Figh, Jeddah, Arabie Saoudite

11 Abdeslam Yassine, leader du mouvement Al Adl oua al Ihssan, *Islamiser la modernité* (Al Afak Impressions Rabat 1998).

1. The complexity of rules relating to real estate and land tax

All the countries of the Maghreb are characterized by the plurality of legal regimes concerning real estate. With regard to private land, regimes of collective, state and tribal ownership are overlapping. The extension of this or that regime of ownership varies from one country to another creating a diversity in the Maghreb detrimental to any effort to harmonize the law in this area. In Morocco, Algeria and Tunisia, however, registration of land tends to become the rule. Libya and to a lesser extent Mauritania continue to use the traditional mode of ownership based on the use of private deeds and oral testimony. The generalization of the Maghreb modern rules of registration of land appears to be a preliminary step and will be concomitant to the harmonization of business law as are the simplification and easing of fiscal rules.

While Morocco, Tunisia and soon Algeria, in accordance with the treaty of association with the EU, proceed with the upgrading of their tax administrations, Libya and Mauritania have retained a tax regime in accordance with the relatively low level of business in these countries. Harmonization is very difficult to achieve in the field of taxation. The EU has not yet accomplished that task, and the AMU pass the issue in complete silence. The Working Committee set up by that commission mentions only the problems of double taxation, investment guarantees, insurance and reinsurance and the tariff nomenclatures, etc.[12] Furthermore, in the Maghreb, the legislation on labour relations appears dated.

2. Obsolescence of the rules on labour relations

In contrast to Tunisia, labour law in Morocco and Algeria is dominated by provisions established in the wake of independence. To ensure a legal framework attractive to international private investment, the states of the region have, since the 1990s, established new labour codes. The difficulty for these countries stems from the fact that the new legal instruments related to the employment relationships must reconcile two imperatives: related to the promotion of international investment on the one hand, and to the protection of the employee, on the other. Thus for example, the labour code, adopted in Morocco, fights against regulating the right to strike and against applying the principle of flexibility. It has to be remembered that the persistence of a large informal sector and the maintenance of customary rules in the traditional sector impede the extension of modern labour law. Major opportunities for harmonization in this area have been completely ignored by the various organs of the AMU. The same applies to the protection of intellectual property rights in industry and commerce.

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[12] See Mohamed Bel Hassan Alaoui (now King of Morocco), *La coopération entre l'UE et les pays du Maghreb* (Parais, Nathan, 1994) p. 153.

3. Ignoring standards of intellectual property protection in industry and commerce

Article 39 of the treaty of association concluded between Morocco and the EU as well as the equivalent provisions in the agreements between Tunisia and Algeria and the EU, oblige the parties to ensure "adequate protection and effective intellectual property rights, industrial and commercial in conformity with the highest international standards." In this regard the treaties establish mechanisms for the regular review of the effectiveness of the implementation of these measures. In the field of cooperation in the fields of standardization and evaluation, Art. 51 para 3 of the Morocco-EU Treaty obliges the parties to cooperate in order to develop "Moroccan structures with regard to the intellectual property in industry and commerce, and quality standards." Thus, at the instigation of the EU, the mechanism for the protection of intellectual property is put in place in the Maghreb. The Moroccan Office of copyright has recently intensified its activities. The harmonization process therefore seems easier to undertake in the Maghreb. The EU can more effectively contribute thereto. Nevertheless, the application of the legal standards remains a problem to be solved by the Maghreb states, which necessarily has a bearing on the harmonization of business law.

III. The difficult application of the legal standard

Any process of harmonization of legal norms not accompanied by measures of implementation remains unfinished and possibly of no avail in the Maghreb. There is, however, often a real incompatibility between the law, on the one hand, and society, on the other. This makes it difficult to apply the standard. But this situation may also result from the standard itself.

1. Obstacles linked to the standard itself:

In our view, these obstacles have two sources: the first is the method of drafting legislation, the second relates to its implementation. The Arabic language is the official language in all the countries of the Maghreb. As a result, these provisions are often translated into Arabic before being submitted to the national parliaments. The translation from one language to another sometimes obscures the meaning of the text. Moreover, the training of judges in the national language essentially makes it difficult to gain access to the text often written in a foreign language. In a report on the evaluation of the legal and judicial sector in Morocco, the World Bank notes, and that applies to all Maghreb states, that "to ensure economic growth and curb poverty, the overall objectives of a judicial reform should include inter alia, the effectiveness of laws and contracts and the sanction of their non-compliance through effective means of enforcement: legal security and access to justice. Laws must have a significant impact on daily life and should be actively implemented by the courts and other government officials."[13] According to the authors of the report, "the legislative process leaves gaps leading to poorly formulated

[13] Report of 13 October, Institut des études judiciaires de Rabat, Extracts, in: Libération (Rabat), 10 October 2003, p. 3.

laws, and inadequate dissemination of the law," and the authors add "the training of lawyers presents a number of shortcomings." But obstacles related to the environment of the standard also have to be considered.

2. Obstacles related to the environment of the standard:

These obstacles are of a sociological nature. They are related to the level of human development in these countries, whose indicators are not satisfactory to the Maghreb countries. Indeed, the Arab world in general and in particular the Maghreb show high illiteracy rates in comparison with other developing countries. Levels of female enrolment are among the lowest in the world. "It is the world region least advanced in terms of access to information technology and communication, surpassed even by sub-Saharan Africa." In the case of Morocco, and the observation applies to other Maghreb countries as well, "the execution of court decisions is a crucial problem; it is widely regarded as a major obstacle to the effective functioning and integrity of the judicial system in Morocco."[14] This fact is a huge obstacle to the harmonization and implementation of business law in the Maghreb. The economic and human development in these countries and a thoroughgoing reform of their judicial systems are all factors that can accelerate and ensure the success of any harmonization of business law. But the key factor which determines the overall harmonization process remains the restoration of trust between the different states of the Maghreb and the creation of a favourable business climate. Activities of the Arab Maghreb Union are likely to contribute thereto.

C. The perspectives of harmonization of business law in the Maghreb

The paralysis afflicting the various departments of AMU since 1994, when the border between Morocco and Algeria was closed, stopped the process of cooperation and harmonization undertaken in the Maghreb. But several initiatives to revive the dialogue were taken, both at the bilateral level and at the level of economic and social partners in the region.

I. The need to reactivate the measures of harmonization undertaken within the AMU

The text of a Maghreb integration strategy was adopted by the third summit of Ras Lanouf in 1991. This text provides that the Maghreb integration will depend on the following four modalities: – Establishment of a free trade zone for the products of North African origin by 1992,

- Creation of a customs union by 1995,
- Establishment of a common market in 2000 and
- finally establishing an economic union.

[14] Report, loc cit.

This strategy requires the adoption of a convention and trade tariff and a customs nomenclature. But the process of integration was struck by inertia, and the sixth Presidential Council held in 1992 reiterated the need to accelerate the establishment of a free trade zone and set up a working group to prepare the texts of a framework agreement.[15] But since 1991, a report prepared by the departments of AMU, listed the obstacles to the implementation of this joint strategy. There are seven of them classified in the following manner: heterogeneity of national economic policies, heterogeneity of industry standards, weakness of instruments financing projects of foreign trade and insurance, presence of obstacles other than customs, weakness in the flow of information between economic partners. Faced with the paralysis of the AMU, the process of consultation was removed from its agenda.

II. The measures put in place outside the UMA

The failure of the plurilateral consultations within the Maghreb has promoted the downturn towards bilateral procedures. Since 1994, commissions of Tunisia and Morocco, Morocco and Libya, Morocco and Mauretania, Algeria and Libya, Mauretania and Algeria were charged so as to enable us to maintain a minimum of economic coordination among the states in the region. The intergovernmental joint commissions meet once a year in one of the Maghreb member countries of the commission to resolve the problems facing the development of economic and political relations between the countries concerned. Some of these joint committees are very active and can, if necessary, serve as an engine to harmonize the legal instruments in the field of business law. In our view, the marocco-tunisian commission plays an extremely important role in developing the level of trade between the two countries. Moreover, both countries are the only two parties of both the Maghreb of the Agadir agreements discussed above. Apart from bilateral cooperation, Arab and Maghreb business people attempt to revive the level of business in the Arab and Maghreb region. Note has to be taken of the Arab Business Council created in Marrakech in 2003. At the end of its meeting, it addressed recommendations to Arab and Maghreb governments, to implement measures for the development of Arab investments in the Arab world and to provide for an increase of the trade between the two geographical areas. These businessmen have also agreed with their European counterparts to create a business council within the "5 + 5" forum devoted mainly to the dialogue between the riparian countries of the western Mediterranean on matters of security, fight against terrorism and illegal immigration.

On another note, it was also decided to set up at the end of 2004, a network of chambers and professional organizations in the Maghreb. All of these initiatives are likely to promote the process of harmonization of business law in the Maghreb. A few proposals along these lines will enable us to conclude these considerations.

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[15] For details see Mohammed Bel Hassan Alaoui, *Les relations entre l'UE et les pays du Maghreb* (Paris, Nathan) loc.cit., at p. 160-167.

III. Some proposals to harmonize business law in the Maghreb

There are seven such proposals each worth to be made subject to an in-depth study. Here it must suffice to pass them in review: inventorize the mechanisms of harmonization already in place, explore ways to ensure the implementation of these mechanisms, identify areas where harmonization is easier to achieve and identify priority sectors, establish a State "initiator" or "facilitator" (Tunisia seems perfectly entitled to play this role in terms of relations with the other four states of the Maghreb), give an overview of harmonization mechanisms implemented in the other regional integration (EU OHADA), involve the economic and social partners of the Maghreb in that undertaking and finally resort to the procedure of "enhanced or specialized cooperation" procedures so as to enable those states of the Maghreb that wish to go further in the harmonization and other states to join them at the time they deem necessary.[16]

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[16] For the EU perspective see Edouard Balladur, *Une nouvelle méthode pour l'Europe*, le Monde of 9 December 2004.

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