

# **MUTUAL RECOGNITION:**

## **rationale, logic and application in the EU internal goods market**

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### **1. Introduction and structure**

Mutual recognition is one of the most appreciated innovations of the EU. The idea that one can pursue market integration, even "deep" market integration, while respecting 'diversity' amongst the participating countries, is bound to be attractive to many. For others, the advantage of the notion is found in the combination of far-reaching economic integration and relatively limited centralisation. After all, under pure mutual recognition, Member States recognize ('horizontally') one another's regulatory regimes and forego centralized regulation. Other authors approve of mutual recognition because they regard it as a necessary condition for 'regulatory competition' between the countries in the Union, which, in turn, should serve as a permanent discipline on governments not to succumb to interest groups advocating costly regulation not justified by market failures. At first, also European business interested in EU-wide market access was applauding mutual recognition as they expected it to drastically simplify the enormous regulatory heterogeneity in the internal market whilst feeling more secure about the exploitation of free movement.

Reading the academic literature on mutual recognition, however, one quickly gets the impression that mutual recognition is many things to many people. Probably the more rigorous 'branch' in this domain constitutes the understanding and appreciation of the case-law of the ECJ. With more than 300 ECJ cases in goods markets alone, the legal analysis has come to be well-established and more or less routine.

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Already a good deal more diverse is the interpretation of the developments in the WTO, in particular in panels and rulings of the Appellate Body. In this area, one has to sharply distinguish the recognition of 'equivalence' of regulatory requirements or related standards in goods trade, on the one hand, and the meaning of Mutual Recognition Agreements (MRA) which is solely governing the conformity assessment procedures, on the other. Going much beyond that, is a body of literature in fields such as political science, political economy and law and economics, where a great diversity of ideas is discussed, often quite far removed from what is actually happening inside the EU.

Is mutual recognition a rule about conflicts between national law from 2 or more countries, or, simply, a rule of choice for one country's law? Is mutual recognition in fact boiling down to "functional equivalence"? Or, can it be characterized as a form of 'decentralized policing'? Distinctions are made between pure mutual recognition, rootless mutual recognition, just 'recognition' and e.g. 'managed' mutual recognition. Further differentiation emerges once one addresses questions such as 'what' is (not) mutually recognized and what alternatives are (not) acceptable.

The present contribution will not cast the net so wide. The focus will be on the most successful and far-reaching example of mutual recognition, that of the EU internal market for goods. The paper attempts to explain the (i) rationale and logic of mutual recognition in the EU internal goods market, (2) its working in actual practice in the EU for more than 25 years, culminating in a qualitative benefit / cost analysis and (3) its very recent improvement in terms of 'governance' in the so-called 2008 Goods package, thereby ameliorating the benefit / costs assessment. For purposes of discussion, a brief section is added on the design problem of the horizontal services directive 2006/123, when proposed as the infamous Bolkestein draft in January 2004. The issue turns around the choice between the origin principle and mutual recognition. It is followed by a short summary of conclusions.

## **2. Rationale and logic of Mutual Recognition**

Going beyond the removal of tariffs and quotas, the EEC had to address 'other barriers' to intra-Community market access. The idea of allowing Member States to apply "national treatment" (host country control in a non-discriminatory way) was of course unattractive, if not inappropriate, given the great ambition of the EEC building a 'common market'.

Two options remained: a prohibition of 'other barriers' or 'approximation' [harmonisation, in French] of national laws with a view of overcoming the barriers.

The design of the Rome treaty incorporates both options. Art. 34 TFEU is not merely about forbidding quotas but also about "all measures having equivalent effect" (to quantitative restrictions). However, an all-out prohibition would amount to a revolutionary amputation of national regulatory autonomy which would make it impossible to uphold the Member States' obligations (often in their constitutions) with respect to a number of risks such as safety and health aspects of goods. Thus, Art. 36 TFEU comprises a series of derogations e.g. about health and intellectual property rights<sup>2</sup>. Art. 114, TFEU (Art. 95, EC) forms the legal basis for approximation for purposes of "... the establishment and functioning of the internal market".

Mutual recognition has emerged from the tensions and problems arising from the combination of these three fundamental treaty provisions. Putting it simple, the Union was caught into a seemingly impossible triangle: Art. 34 could not be relied on in a blanket form as this would erase the capacity of Member States to regulate, if only for correcting or overcoming market failures; Art. 36 could not be relied on too much either since this would make a mockery of the common market idea, with more holes than a good Emmenthaler cheese; but also Art. 114 was not a panacea either as it would imply building a vast EU regulatory regime over many decades, amounting to a drastic de-facto centralisation. Moreover, the decision-making ex Art. 114 was still under veto and the mistrust amongst Member States as well as vis-à-vis the Commission was such that EU rules were only acceptable to all if no discretion for escape or disguised protectionism would remain (the so-called Old Approach, going into extreme detail and with full technical specifications).

In order to appreciate the ECJ case law from which mutual recognition emerged, one has to understand not only this impossible trilemma but also the difference between the treaty concept of 'free movement' and free trade. Had the Rome treaty relied on free trade, mutual recognition might never have been invented or at best in an intolerably crippled version.<sup>3</sup>

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<sup>2</sup> Art. 34 TFEU was Art. 28, EC and Art. 30, EEC ; Art. 36, TFEU was Art. 30, EC and Art 36, EEC. Their text was never amended.

<sup>3</sup> An insightful elaboration of how far one might go under free trade is provided by Alan Sykes (1995). Under free trade, a country agrees not to impose tariffs and quotas and can bind itself under a treaty but remains autonomous otherwise. Such (mainly regulatory) autonomy can be further constrained in limited ways under the WTO. See e.g. Weiler, 2005 ; Sykes, 1995 ; Trachtman, 2007.

Free movement is much more compelling than free trade<sup>4</sup> as it forces the country into a different position: the right of market access (here: inside the EU) is not negotiable but guaranteed as such, and the country can only deviate by explicit derogations as specified in the treaty or ECJ case law. Thus, free movement needs to be ensured by stringent prohibitions of non-tariff measures such as quotas as well as the panoply of regulatory barriers. Otherwise, it would degenerate into free trade inside the EU customs union. Art. 34, TFEU was legalistically interpreted. Hence, the term 'measures with an equivalent effect' would not catch anywhere near the number and types of 'regulatory barriers' required to render free movement meaningful in the internal goods market. Once the ECJ understood that free movement requires an 'economic' interpretation of this prohibition (rather than a formal and too literal one), it ruled in *Dassonville* (C-8/74) that such measures (i.e. what we call "regulatory barriers") refer to trading rules "capable of hindering, directly or indirectly, actually or potentially, intra-Community trade". This strict prohibition is balanced by derogations, which need to be *respected but also disciplined*, otherwise they would undermine the accomplishment of free movement.

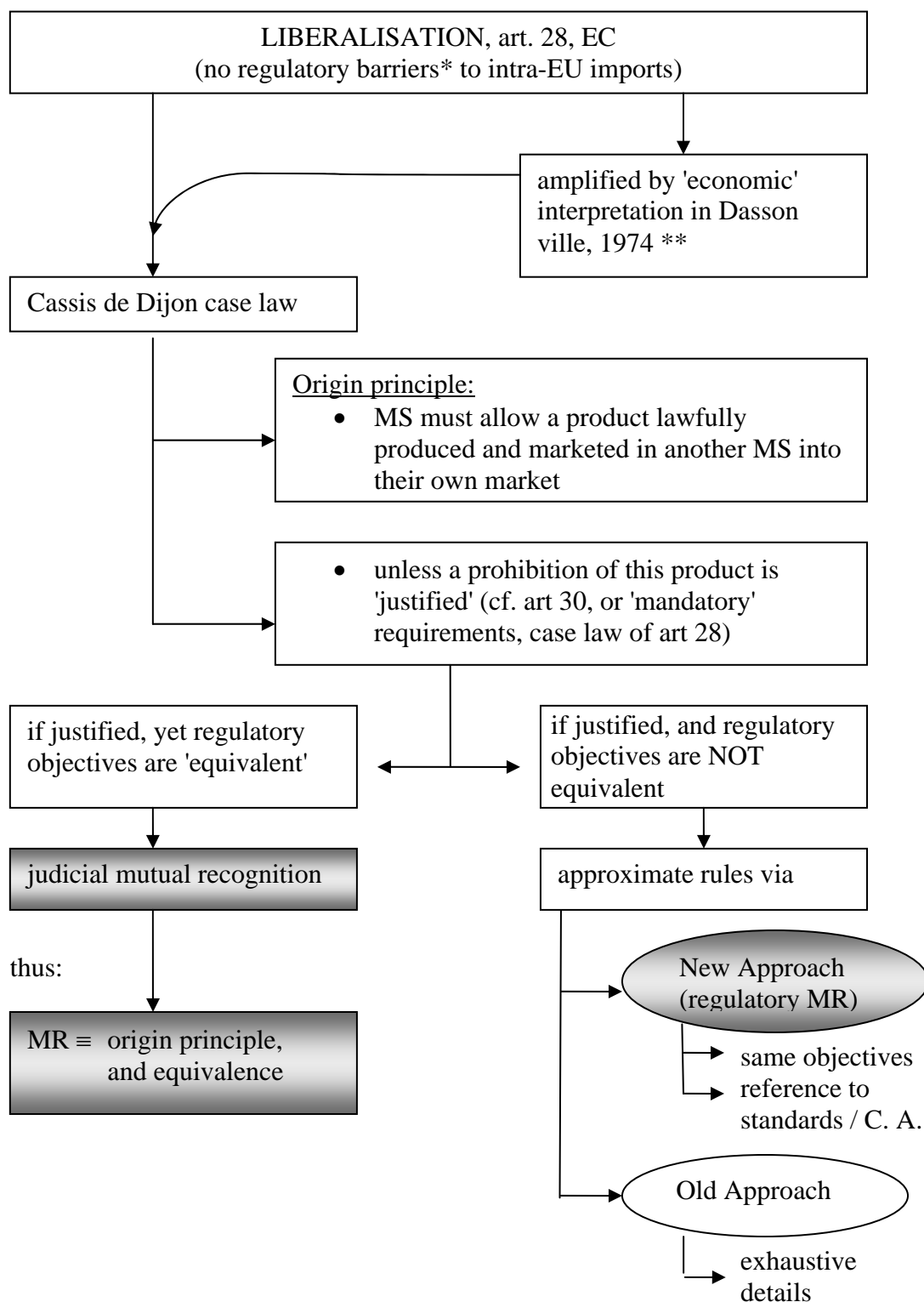
It is here that the *Cassis-de-Dijon* (C-120/78) case law comes in, leading to mutual recognition (MR). See also Figure 1. Following logically from *Dassonville*, the ECJ first defines what has now come to be called the "origin principle": "Member States must allow a product lawfully produced and marketed in another Member State into their own market..". Member States can block imports or condition them but only if "justified" (the derogations listed in art. 36, TFEU, and the case law, based on the rule-of-reason, on art. 34, TFEU itself). As noted above, the issue is how to respect *and* discipline the recourse to these derogations. Case law since *Cassis de Dijon* does both (!) by asking whether a formally justified recourse to derogations really matters for the risks consumers or workers run in the internal market.<sup>5</sup> The overwhelming majority of the exceptions invoked relate to what could be called "SHEC" type regulation, that is, related to objectives of Safety, Health, Environment or Consumer protection.<sup>6</sup> SHEC regulation is in essence 'risk regulation'.

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<sup>4</sup> Parts of the following and Figure 1 are adopted from Pelkmans, 2007.

<sup>5</sup> Note that this test can be regarded as an early manifestation of a shift from form-based legalistic justifications to effects-based economic approaches, as is now customary in e.g. EU competition law.

<sup>6</sup> The notion of SHEC is a simplification but it catches the large bulk of regulatory issues related to MR. It is also relevant in services, be it that investor/ saver protection should be added as a special case. In Art. 36, TFEU the key references are to health and safety and possibly elements of environmental policy. The rule-of-reason case law ex. Art. 34, TFEU explicitly underpins environmental and consumer protection. All other justifications are either of trivial importance (e.g. arts trade) or relate to IPRs. For legal analysis, see Barnard, 2007, chapters 6, 7 and 19 and Weiler, 2005.

**Figure 1: Logic of Mutual Recognition goods**

\* Art. 28 speaks of 'measures having an equivalent effect' to 'quantitative restrictions'. Since Dasonville, this is tantamount to regulatory barriers

\*\* What we call 'regulatory barriers,' are defined by the ECJ as "all trading rules enacted by MS which are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade."

C.A. = Conformity Assessment

If the risk reduction aimed for is similar, the regulatory objective is essentially the same, and a good can be freely imported. Note that, in actual practice, civil servants or inspectors may focus on the detailed specifics in their national laws, indeed, that is likely to be their routine instruction. The ECJ, after critically inspecting the measures on the basis of principles such as non-discrimination and proportionality, verifies whether the regulatory objectives in the origin and destination countries are "equivalent".

If equivalent, the derogation cannot be invoked. After all, the effect in terms of risks to consumers, workers, etc., is then similar so that the barrier cannot be justified. The importing Member State ought to 'recognize' that the regulatory regime of the exporting Member State does not increase risks in an appreciable way. In so doing, the ECJ implies that MR amounts to the combination of the *origin principle and equivalence*. This is 'judicial MR' (left bottom boxes in Figure 1).

If not equivalent, the derogations do apply and the only way to restore free movement is 'approximation' as the treaty says. However, even here MR can lead (and did lead) to a highly significant simplification. After all, there is no reason why, in approximation, the issue of equivalence should not be a priority, too. Thus, the New Approach is based on directives where the joint definition of regulatory (SHEC) *objectives* is the heart of the matter. Once objectives are commonly defined, the lack of equivalence is by definition removed and can no longer be a reason to hinder imports. The Old Approach (mainly developed before Cassis de Dijon), by contrast, harmonizes by attempting to unify almost all technical aspects of (SHEC) regulation, including extremely detailed technical specifications, testing, approvals and certification. It violates the respect for diversity.<sup>7</sup>

The Old Approach can only be justified economically in cases of extreme risks where uncertainty is potentially too costly: the high costs of extreme specification are overcompensated by the benefits of avoiding unacceptable risks. The New Approach is a lot easier to negotiate since it is predominantly about regulatory objectives. There is, in addition, a learning process among the Member States precisely because they cannot normally fall back on specific technical solutions, driven by engineers, but have to focus on risks, risk reduction and performance requirements.

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<sup>7</sup> For details, see Atkins (1997). See Pelkmans (1987) for the many drawbacks of the Old Approach. Typical examples of this approach are the 23 tractor directives, the 1973 chocolate directive (meanwhile revised considerably), the more than 50 car and car components directives enacted during the 1970s and 1980s (also revised since then) and pharmaceuticals regulation.

Thus, the market failures are addressed whilst the costs of EU regulation fall considerably. The New Approach is therefore not synonymous with MR but the underlying thinking is closely related, which is why it can be referred to as 'regulatory mutual recognition'. This phrase refers to the common definition of regulatory objectives in a light directive.<sup>8</sup> The absence of further technical details implies that different technical requirements are subject to MR. The sensitivity of this type of risk regulation is such that both Member States (e.g. inspectors where relevant) and business are in need of greater practical guidance about what is 'recognized' in markets; after all, one light directive might refer to many thousands of quite distinct goods.

Thus, in the New Approach, the common objectives in light directives are complemented by 'reference to standards'. A carefully structured regime has been set up which develops (voluntary) European technical standards on the basis of 'mandates' issued by the European Commission, in turn derived from the SHEC objectives in the relevant directive(s). Market participants, and not Eurocrats or national civil servants, develop standards for the EU. The Commission recognizes these standards (if a correct follow-up of the mandate) and, after official publication, business can rely on them for intra-EU free movement.<sup>9</sup> This regime is much appreciated because it provides business with guidelines and certainty. European standards incorporated in a regulatory MR regime are also attractive because they do remain voluntary. In case a company is innovative and creates novel aspects or techniques or uses new materials not foreseen in a European standard, the new good can be tested directly on the compliance with the SHEC objectives in the relevant directive(s).

Unlike the old approach, innovation is not throttled for two reasons: performance standards rather than design standards are obligatory and a company is, even with the flexible performance standard, still free to construct 'around' the standard (though it needs to acquire certification from a so-called Notified Body, assigned to fulfil these tasks).

In short, as Figure 1 sets out, judicial Mutual Recognition amounts to the origin principle in its pure formulation, together with equivalence of regulatory objectives of Member States, whereas its main alternative, regulatory MR, consists of the common regulation of SHEC

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<sup>8</sup> A typical case is the toys directive 88/378/EEC, recently revised as dir. 2009/48/EC of 18 June 2009. An extremely broad application is the machines directive 98/37/EC covering more than 40 000 types of machines.

<sup>9</sup> This is legally referred to as the "presumption of compliance". For European business, this is cost saving in terms of information and incentivising in terms of legal certainty. Companies, when making technical products, will have few difficulties in following European performance standards in their in-factory manuals. If done faithfully, the goods will then enjoy intra-EU market access, without the need to master complex EU case law.

objectives, together with mutual recognition of all the specific technical requirements in national laws facilitated by recognized European performance standards. In both approaches, therefore, the quite sensational result is that existing technical details in national laws, supposedly to be enforced by the responsible inspectors or civil servants, *cannot* be used to block intra-EU imports, except if that good does not comply with recognized European standards or clearly violates SHEC objectives themselves.

### **3. Preventing new regulatory barriers from arising**

MR, whether judicial or regulatory, pays attention to the *stock* of regulatory barriers in the internal goods market. But focussing on the stock is rather narrow-minded. Perhaps it is too little realized but Member States have grown into genuine 'regulatory machines'. The painstaking case law based on MR and the enormous standardisation work linked to the New Approach - no matter how helpful - completely ignores that Member States tend to create a steady *flow of new* regulatory barriers year after year. Although there is (rightly) attention to discipline the EU level production of ever more EU regulation via a subsidiarity test whilst raising its quality via impact assessment, far too little attention was long paid to the generation of goods-related national regulation liable to create new regulatory barriers. It is not possible to assess whether the stream of new or amended measures coming from Member States outweighs the removal of barriers accomplished via MR and the New Approach.

However, it is possible to show convincingly that the internal goods market would long have been hopelessly constricted, if the EU would not have introduced an amazingly tough control and correction system for new national legislation in process.<sup>10</sup> This system is also based on ideas underlying MR, topped up by an intrusive and stringent notification system (with tough sanctions in case of non-notification, emerging from firm rulings by the ECJ), close monitoring by the Commission of failures to notify, detailed scrutiny of draft laws of Member States by a special Committee chaired by the Commission, and – most remarkable of all – automatic or semi-automatic suspension of the national legislative process for periods varying from 3 months to as much as 18 months, dependent on the need for remedies and their nature. This contribution is not the place to discuss all the features of the regime (Pelkmans, Vos & di Mauro, 2000).

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<sup>10</sup> The Mutual Information directive 98/34 (before 83/ 189/EEC), recently amended as dir. 2006/96/EC, OJEU 2006, L 363, p. 81. The Committee is still called the 98/34 Ctee.

What matters for present purposes is how central MR is to the remedies sought. The basic requirement for these national regulations is that there be explicit and clear clauses on MR or 'equivalence'. After all, regulations where Member States still have regulatory autonomy (in goods) must be in the 'non-harmonized area' and that is where MR ought to apply. Such clauses can be attached to the objectives or the technical standards referred to. This reference to standards becomes more effective over time as CEN and CENELEC<sup>11</sup> increasingly write standards which, by definition, are valid for all EEA countries, Turkey (due to the customs union with the EU), Switzerland and several other European countries. In a rising number of instances, such standards may be identical with world standards.<sup>12</sup> When world standards are used in such instances, MR extends to imports from third countries if adherence to these standards is ensured by credible conformity assessment. The large majority of national draft laws passing the 98/34 committee either contains equivalence clauses by now or are adjusted after insistence by the committee (Pelkmans, Vos & di Mauro, 2000). If the enacted laws, later, do not have such clauses, they infringe EC law, and are unenforceable against intra-EC imports. The conclusion is that the regime, backed up by significant resources and efforts as well as by firm ECJ rulings forms a powerful and credible agent for mutual recognition to be maintained and to become more 'visible' for business over time.

The numbers are impressive. Between 1988 and 1998 the total number of national notifications was about 5000 and the trend was upward (Pelkmans et al., 2000). In the period 1999 to 2005, the annual rate was close to 600 a year and moved up once the new Member States came in (Pelkmans, 2007). The comments and so-called detailed opinions from other Member States and the Commission during those seven years suggest that some 2100 laws were suspected to cause barriers in future. These staggering quantities of national regulations and decrees, if gone unchecked, would have made a mockery of the internal goods market.<sup>13</sup>

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<sup>11</sup> These two and ETSI (telecoms and internet standards) are the three European standardisation bodies, linked to the New Approach and other EU regulatory initiatives via Memoranda of Understanding.

<sup>12</sup> CEN, CENELEC and ETSI have agreements (e.g. the Dresden and Vienna ones) with ISO and IEC as well as the ITU which facilitate the fullest possible use of world standards when writing European standards. In reality, it is often the other way around : European standards are quite often used as (a basis for) world standards. The EU is far more active than e.g. ANSI, the American Standards body in ISO, in world standardisation.

<sup>13</sup> That Member States are regulatory machines is realized even better if one knows that these new regulations relate to only one-third of all goods traded in the EU. Some 50 % fall under harmonized rules (hence, Member States can no longer enact alone in these areas) and some 20 % are unregulated goods markets.

#### 4. Benefits and Costs of EU Mutual recognition until 2008

It is insightful to subject MR in goods to a benefit/cost analysis. This is done in Table 1 and briefly elaborated in the text of the present section.<sup>14</sup> There are many benefits to MR, whether judicial or regulatory. Table 1 suggests three categories of benefits. First, regulatory benefits, in the sense of better regulation. If MR is purely judicial, Member States' autonomy with respect to regulatory objectives is retained due to their 'equivalence', even though free movement prevails. If MR is regulatory, the treaty prescribes a high level of protection (typically, in SHEC-type risk regulation), so that there can be no race to the bottom via bargaining. Moreover, there will be a bias against regulatory failure of Member States because technical specifications (which might lead to overregulation) are no longer in directives, whilst the technical standards referred to are based on performance criteria rather than design (i.e. prescriptive detail).

Second, strategic benefits relate to the deepening and quality of the internal market. If MR is judiciary, the breakthrough was and is that free movement prevails whereas it was hindered or blocked before. It accomplishes this without adding any EU regulation, that is, it avoids centralisation. Moreover, judicial MR disciplines Member States' overregulation, since their rules cannot stop intra-EU imports originating from regimes with lighter rules (as long as the objectives are equivalent). Finally, judicial MR forms the basis for 'regulatory competition' without a race to the bottom which goes further than MR in a static sense.<sup>15</sup> If MR is regulatory, the deepening of the internal market is accelerated because lengthy negotiations can be avoided (including blockages on technical details) and agreement on goals is easier. Furthermore, it disciplines overregulation at both levels of government, since the focus is on objectives and the reliance on European performance standards reduces considerably the scope for idiosyncratic (or, protectionist?) specifics. Regulatory MR does add EU rules but minimally so, compared to the Old Approach.

The third benefit concerns economic welfare which is what the internal market is all about: MR is pro-competitive<sup>16</sup>, if not strongly pro-competitive at times compared to its alternatives, be it that strategic quality games cannot be excluded (given that equivalence of objectives is to be satisfied).

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<sup>14</sup> This section, including Table 1, is adapted from Pelkmans, 2007, with relatively minor changes.

<sup>15</sup> See Sun & Pelkmans, 1995, for an elaborate assessment of the conditions for regulatory competition in the EU internal market for goods to occur, and improve welfare, with a case study in goods and one in services.

<sup>16</sup> Economists have largely ignored the rigorous analysis of MR, probably because it is problematic to model the options properly. A survey is provided in Pelkmans 2005, pp. 97 – 102.

**Table 1: Benefits and Costs of mutual recognition**

<i>types of</i> <b>BENEFITS</b>	<b>judicial MR</b>	<b>regulatory MR</b>	<i>types of</i> <b>COSTS</b>	<b>judicial MR</b>	<b>regulatory MR</b>
<b>regulatory</b>	autonomy MS retained for objectives	common SHEC objectives ensured  bias against 'regulatory failure'	<b>information</b>	MR 'invisible' for economic agents, except at high costs (w/o clear MR clauses)  even if info is collected, many 'grey areas'; uncertainty (e.g. case law) for business and MSAU  no rule book imposed on MSAU	some modest uncertainty, if European standards are lacking or innovation is used
<b>strategic</b>	free movement prevails  over-regulation of MS disciplined  basis for regulatory competition w/o race to the bottom  no (add'l.) EU rules	internal market deepening accelerated  over-regulation MS & EU disciplined  only minimal (extra) EU rules	<b>transaction</b>	monitoring extremely costly, evidence anecdotal at best  When MSAU refuse, reputation and waiting costs, little (EU) help (except SOLVIT)  assuring rights for business unattractive, costly and slow	regulatory & standardizers' networks monitor and solve, partly (with delays)  (idem, but rare)
<b>economic welfare</b>	pro-competitive	pro-competitive	<b>compliance</b>	unknown, possibly serious costs for existing rules	

*Notes:* MS = Member States; MSAU = MS Authorities

*N.B.* This table merely assesses MR of existing rules (that is, section 2 and not section 3 of this paper)

With this litany of advantages, MR seems almost too-good-to-be-true. Indeed, this is how, naively, MR is often portrayed among economists. Also in European law, however, and even in political science, there is an inclination to neglect the considerable drawbacks of MR in actual practice, both for business and authorities, whether EU or national. It is important to appreciate the costs of MR for business and authorities.

Table 1 distinguishes three types of costs. First, information costs, which are especially large for judicial MR. After all, MR is 'invisible' to economic agents, unless specific laws contain clear equivalence clauses, be it on objectives or standards. What economic agents 'see' are the requirements in local laws. Since judicial MR is developed in ECJ case law, numerous businesses have no idea about MR or that it might matter to them, let alone that companies would know how to verify whether it is applied to their goods.[ One costly consequence of this ignorance is that many SMEs fail to consider MR and thus either refrain from exporting to countries, or, do export but after adaptations, which is exactly what MR aims to avoid. For companies which do know about MR, the costs of verifying whether MR would apply to their goods can be high and/or lead to uncertainty. In addition, there are costs because of 'grey areas' about when 'equivalence' applies, both for business and the authorities, even when national authorities do act in a spirit of MR. Unfortunately, the lack of a 'rule book' for MR, in particular for national inspecting agencies or other officials, causes most civil servants not to act in that spirit; rather, they often attempt to enforce local rules. The Commission has gradually come to realize the downside of judicial MR and issued reports and soft guidelines, it has also greatly improved the information on its (TRIS) website<sup>1</sup>, promoted seminars and launched a special campaign for the new Member States. Vis a vis business this is unlikely to help much because many SMEs tend to ignore such general campaigns. For officials the utility is greater. For regulatory MR, information costs are far lower.

Second, transaction costs are also substantial for judicial MR. However, hard evidence about transaction costs is scattered and/or anecdotal, with little idea of how representative these data are, as the Commission cannot monitor judicial MR. Case studies indicate that in particular SMEs are deterred by actual transaction costs as well as by uncertainty. The deterrent effect is greatest when Member States' authorities routinely refuse market access if a good does not match local technical requirements. Imposing withdrawal implies a loss of reputation. This is followed by waiting costs, which can only be reduced drastically if bilateral cooperation between Member States is quasi-automatic or the Commission intervenes. The recent SOLVIT voluntary cooperation procedures<sup>17</sup> are beginning to help fill this gap.

Furthermore, business is often hesitant to ensure their rights under Community law.

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<sup>17</sup> SOLVIT is an on-line problem-solving network of national officials, coordinated by the Commission. It tackles complaints about the misapplication of internal market (and other EU) law by public authorities but without legal proceedings, in a period of no more than ten weeks. In September 2006, SOLVIT claimed a success rate of 75 % of cases solved 'informally', a clear incentive to use it, although some Member States leave their SOLVIT units understaffed, thereby frustrating the process. Some 16 % of the cases are about market access of goods. See [http://ec.europa.eu/solvit/site/index\\_en.htm](http://ec.europa.eu/solvit/site/index_en.htm).

One reason is that future business in the destination country ought not to be jeopardized. Besides, the pursuit of one's rights under Community law is very slow and costly. Business often rightly note that legal progress about free movement should not be conquered by them but reasonably guaranteed by the system.<sup>18</sup> It is striking that these costs are arising, in part, from the absence of networking and sound investment in bilateral cooperation inside the Union. The contrast with regulatory MR is significant. In sectors covered by the New Approach, regulatory and standardizers' networks broadly monitor, contacts are not anonymous, occasional network meetings take place and some problem solving does occur, be it with delays. As a result, assuring one's rights is rarely necessary.

Third, compliance costs typically exist when judicial MR fails; under regulatory MR they are exceptional. However, there is no reliable evidence on compliance costs.

MR in the EU goods market is thus characterized by multiple and substantial benefits and a number of costs which, for business, tend to accumulate to often deterrent levels. There are also costs for national authorities when they enforce rules in the spirit of MR. The disturbing conclusion, at least for judicial MR, is that the very companies relying on MR in the internal market are hardly 'protected' by its regime. The incentives are therefore perverse and they will have to be altered into positive ones for judicial MR to engender the much wanted benefits for the Union. The picture for regulatory MR is far brighter.

## **5. Restoring mutual recognition incentives under proper EU governance**

For about a decade, the Commission and stakeholders, including business, standardisation bodies, testing and certification bodies (including Notified Bodies, assigned by the EU to execute conformity assessment under the New Approach), accreditation networks in Europe, consumers, the EU Economic and Social Committee as well as Council working groups and the IMCO committee of the European Parliament, have cooperated in relative tranquility in

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<sup>18</sup> The frustrations about the practical problems or indeed neglect of MR were so strong that European business began to turn away from MR. A first manifestation of this turn-around can be found in the Molitor report (1995) and the UNICE (1995) regulation report. With a delay the Commission started to recognize these issues, once it moved away from a narrow case-law based mindset about MR. See COM(1999)299 of 16 June 1999, on MR in the internal market and COM(2002)419 of 23 July 2002, the second bi-annual report on MR. Examples were published in the Internal Market Scoreboard no. 10 of May 2002. How deep business frustration ran, however, is clear from UNICE, 2004, under the telling title : "It's the internal market, stupid!", with many examples of neglect or misapplication of MR. Indeed, it appears from interviews of businesses having relied on MR that "firms find themselves unwillingly appointed as guardian of the Treaty (here, free movement under MR), chasing violations at their own costs" (Pelkmans, 2005, p. 123).

order to introduce appropriate 'governance' systems ensuring that MR would work much better in the single market. The outcome has been the so-called 2008 Goods Package. It consists of three pieces of EU legislation : one on the application of MR by Member States and the obligations of companies ( Regulation 764/2008), and two on overcoming the imperfections of the New approach (Regulation 765/2008 and Decision 768/2008).<sup>19</sup>

After a brief note on the latter two pieces of EU legislation, the focus will be on MR regulation 764/ 2008. The accreditation & market surveillance regulation 765/2008 addresses four concerns of the New Approach : accreditation, market surveillance, import controls and CE marking. None of these affect the fundamental link between the New Approach and MR (the agreement on common objectives, hence equivalence) but two of them are relevant for secondary instances of MR in the New Approach. The first one is concerned with the MR of certificates issued by Notified Bodies. The system used to work as follows. All Member States designate conformity assessment bodies capable of living up to the EU quality requirements and the indicated subsectoral specialisation (of verifying testing, etc.) and 'notify' them to the Commission. These Notified Bodies are published in the OJEU and thus become competent to issue certificates on products, confirming that such products are produced in conformity with the relevant European standards and that the testing undergone has properly been executed according to the Global Approach<sup>20</sup>. Since all Notified Bodies are technically competent, whilst the Global Approach is EU-wide, it became possible (and attractive for business) to generate competition between such Notified Bodies, without reducing quality requirements of certification. Thus, one could produce in EU country A, test the good in B, certify it in C and sell it in D. These certificates were mutually recognized by national authorities. Gradually, however, it turned out that Member States notified national bodies without a thorough investigation whether or not they lived up to the high standards set for such bodies. Moreover, the number of such Bodies increased far beyond what could reasonably be expected to represent a cluster of viable institutions.

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<sup>19</sup> Reg. 764/2008 ( the Mutual Recognition regulation) of 9 July 2008 laying down procedures relating to the application of certain national technical rules to products lawfully marketed in another Member State and repealing Decision 3052/95/EC, in OJEU of 13 August 2008, L 218, pp. 21 – 29 ; Reg. 765/2008 (the accreditation & surveillance regulation) of 9 July 2008 setting out the requirements for accreditation and market surveillance relating to the marketing of products and repealing Reg. (EEC) 339/93 in OJEU of 13 August 2008, L 218, pp. 30 – 47 ; Decision 768/2008/EC of 9 July 2008 on a common framework for the marketing of products, and repealing Council Decision 93/465/EEC in OJEU of 13 August 2008, L 218, pp. 82 – 128.

<sup>20</sup> The Global Approach is the Conformity Assessment "twin brother" of the New Approach and provided a number of modules for testing, dependent on risk and other properties. See Council Decision 93/465/EEC on conformity assessment procedures of 22 July 1993, OJEC L 220 of 30 August 1993.

Early 2009 there were more than 2100 Notified Bodies whereas the sector estimates that somewhere between 500 and (max.) 1000 such Bodies can be viable given the workload in the market. This number must imply that many Bodies would not pass a serious peer review for the specialisations indicated, since the high qualifications of specialized staff and the differentiated, often expensive equipment generate minimum cost levels, in turn demanding sufficient scale, before being able to break even. Eventually, this led to incidents and mistakes, undermining the confidence needed for MR of the certificates. Reg. 764/2008 creates an accreditation system for Notified Bodies, with accreditation bodies being forbidden to be active in the market otherwise; with one such body per Member State, no commercial interest can be at stake. Ensuring the permanent and high quality of accreditation is the new European Cooperation for Accreditation (EA), including regular peer review and the adherence to several world standards for this task. Thus new set-up will first prompt a considerable consolidation of the sector and gradually restore the trust needed for the MR of certificates.

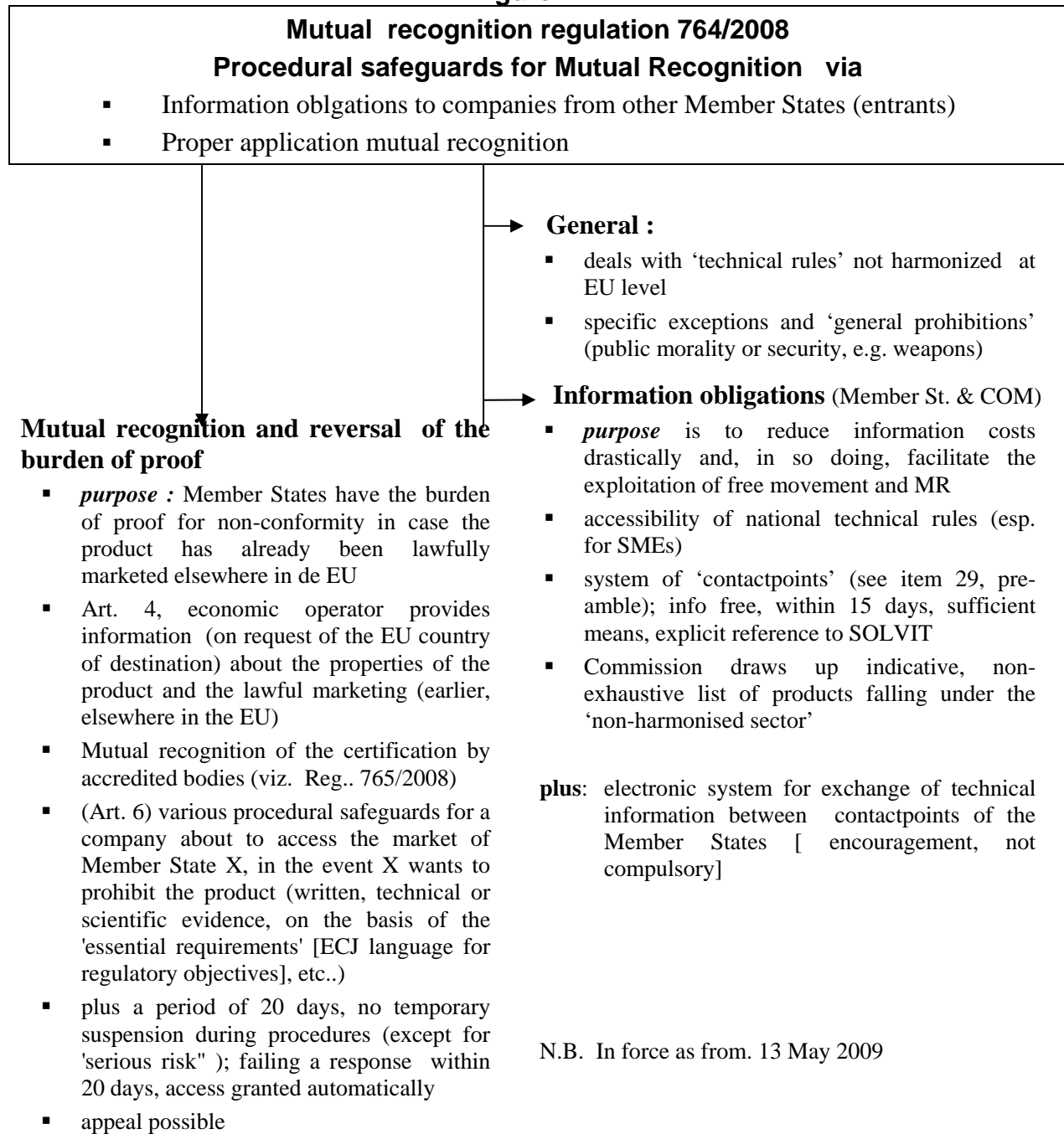
The other problem was CE marking. The CE mark is a sign that the product conforms to all EU rules and relevant European standards. It can be affixed either following the acquisition of a certificate from a Notified Body, or (with module A of the Global Approach) after self-certification. The new regulation clarifies that the manufacturer is responsible, no matter how the value chain is set up, so that attempts to shy away from such responsibility if a mistake originates with a supplier are no longer possible. Again, this responsibility is another cornerstone of the trust in CE marks in the entire internal market. Another problem with CE marking is found in the confusion on the part of consumers, not least because in some countries (e.g. Germany with the GS mark) local marks are suggested to be (more?) safe. Art. 30, sub 5 now forbids this concurrence.<sup>21</sup> The sensitivity of consumer organisations is nonetheless understandable as CE marking due to self-certification is also often used by foreign producers. The discoveries of defect or substandard imports carrying a CE mark have increased appreciably in the last decade. The answer in Reg. 765/2008 is to tighten import controls by the relevant authorities as well as mandatory cooperation between Member States in this respect.

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<sup>21</sup> In Germany, an additional problem was the de-facto barrier to market access that the GS mark caused, compounded by the fact that the German federal ministry of Labour and Social Affairs is formally involved and that the tests – entirely against the certification tradition – remain unpublished. Some 80 % of the cases verified by EFTA (2008) show exactly the same health and safety requirements as behind the CE mark.

The Mutual Recognition regulation 764/2008 constitutes a response to the numerous complaints and criticisms about the factual working of MR on the 'ground'. The purpose of the regulation is to significantly reduce the various costs of MR to European business. It does this via two routes : (a) information obligations (e.g. on technical requirements in rules for the relevant goods) are imposed on EU countries in order to help companies from abroad (but EU) intending to access the local market as well as administrations of other Member States ; (b) a detailed specification of how a correct application of MR brings with it extensive procedural safeguards, such that the burden of proof of not granting MR is essentially on the importing Member State. The first track lowers or eliminates the information costs so that companies merely incur the ordinary business risks when accessing a national market in the EU: good for them and good for (actual or potential) competition in the single market as a whole. The second track respects the national regulatory autonomy and the public interest pursued via regulation (as the MR case law does as well), but imposes disciplines on the Member States in shifting the burden of proof for not respecting MR, even when goods have already been marketed elsewhere in the internal market, onto those authorities. The required proof is subjected to EU rules which protects the companies against arbitrary or too hastily decided barriers. Moreover, the rules impose transparency and facilitate appeal. For all these reasons, the regulation is a genuine relief for business, in particular SMEs. Figure 2 summarizes the key provisions.

The information obligations for Member States have to be organized structurally via so-called "contact points", behind which a system has to be set up making it possible to access and provide highly specialized technical information (what laws and decrees ? what (national or European ) standards ; what institutions involved ?). This is to be done for free (as a right) and within two weeks. The back-up system has to dispose of sufficient means in order to be capable of delivery throughout the year. The 27 contact points are expected to be in touch with one another routinely (a new electronic system might be set up for that purpose) so as to make MR work much better and without much ado. This should be an effective underpinning of mutual trust, indispensable for smooth MR. A further 'service' to European business is the announcement of a list of goods falling under MR, in eurospeak the "non-harmonized sector".

**Figure 2:**

Meanwhile, a first version of such a list has become available but it is not improbable that improved and refined lists will follow in the future since the identification of exactly what does and does not fall under MR is not always easy.<sup>22</sup>

<sup>22</sup> This only goes to show that, in some cases, European business was, and to some extent still is at times, uncertain about the relevance of MR to their products. The list can be found at <http://ec.europa.eu/enterprise/intsub/a12/> .

The reversal of the burden of proof is new but can, in fact, be traced back to an Interpretative Note of the case law on MR in 2003.<sup>23</sup> The procedures are prescribed in considerable detail and avoid that a company is left in limbo : suspension of the import is not allowed unless there is a 'serious risk' and long delays (beyond a total of 40 days) will result in automatic market access. One does not need to read more than the UNICE reports (op. cit. ), the two Commission communications on MR of 1999 and 2002 (op. cit.) as well as the Interpretative Note to appreciate what a great difference the reversal implies for European business : apart from the psychological effect, Member States will be forced to alter their administrative conduct at all levels and firms will be able to enforce their rights under much greater legal certainty and with lower costs, if any.<sup>24</sup>

It is important to underline that nothing in these procedures affects the SHEC objectives of national regulations. If there is a genuine issue of non-conformity, the Member State has every right to take the good from the market and the Commission will normally support that. Finally, a subtle difference between Reg. 764/2008 and the previous rules consists in the MR of certificates. From now on, this general term covers voluntary certification as well (that is, outside the New Approach and therefore possibly of relevance to [unharmonized] national regulation). For business, this is an efficiency improvement since companies often insist on testing other properties than the EU SHEC requirements (for example, durability or consistent quality, especially for components). More often than not, Member States refused to recognize such voluntary certification done elsewhere where it mattered for their national requirements.

It would seem that the MR regulation has rightly been applauded as the appropriate 'governance' to make MR work as intended and thereby deepening the internal market for goods, whilst improving its effective functioning.

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<sup>23</sup> Interpretative Communication on easier access for goods, practical application of the MR principle, in OJEC C 265 of 4 November 2003, in which also many instances of improper conduct by national authorities are discussed, showing the necessity of the reversal for business. The reader should also realize that the ECJ is wary of employing the term "mutual recognition", even though it is the very source of the idea. However, in the Preamble of Reg. 764/2008, the term MR is employed without reservation.

<sup>24</sup> More examples of problems caused by Member States are found in Atkins, 1997 and in Pelkmans, 2005.

## 6. Mutual recognition or the origin principle in horizontal services liberalisation?

MR in the internal goods market has now been improved substantially and subjected to better 'governance'. The system should function as intended. The contrast with services is striking. It is interesting to pose the question whether the lessons and experience in goods can be transferred, perhaps with some adaptations, to the internal services market, in particular, to horizontal liberalisation of services as first proposed by Commissioner Frits Bolkestein in January 2004.<sup>25</sup> Horizontal liberalisation applies only to those services sectors not regulated and liberalized under EU rules of a sectoral nature. The regulated sectors, by definition not falling under horizontal liberalisation, include financial services (banking, insurance, securities, asset management), the six modes of transport and electronic communications. It is a little more complicated for network industries like postal services and gas & electricity, but for present purposes they can be ignored.

In order to clarify the question posed, it is good to remember that the Bolkestein draft dealt with both free movement of services and with the right of (unhindered) establishment. The issue of juxtaposing MR and the origin principle relates solely to free movement. Bolkestein's choice for the origin principle cannot be understood in isolation: the issue is the *design* or architecture of the directive. The Commission's proposal was leaning heavily on services case law.<sup>26</sup> The logic ran as follows. For the services not sectorally regulated at EU level, horizontal liberalisation was based on (a) the origin principle, but subject to the posted workers directive 96/71<sup>27</sup>, but (b) accompanied by a host of derogations, which, in turn, were disciplined by typical case law conditions like proportionality and a verification of whether an objective of public interest was "already protected" by virtue of regulatory action in the country of origin. The latter is of course reminiscent of MR. The derogations consisted of four types: (i) those related to Art.s 45 & 46, EC on public order etc.; (ii) those following from the 'rule of reason' of the ECJ, justifying mandatory requirements<sup>28</sup>, (iii) derogations specified in a directive other than the two categories above, (iv) specific & temporary derogations.

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<sup>25</sup> COM (2004) 2 of 13 January 2004, Proposal for a directive on services in the internal market. Note that the term 'services' can only refer to 'economic' services as e.g. social services are not part of the internal market. Do note as well that the Bolkestein draft was focussed on B2B services since consumer contracts were excluded.

<sup>26</sup> See European Commission, 2001, Guide to Case law, freedom to provide services, DG Internal Market and Services ; but it went further (see Hatzopoulos, 2008 and Barnard, 2008). These technicalities are left out here.

<sup>27</sup> Note that later screening of national restrictions was also implied and this could in some cases lead to later harmonisation.

<sup>28</sup> This could refer to SHEC type objectives, other network industries than those already excluded, (self-) regulation of the professions and e.g. IPRs.

This design is attractive if Member States (and the EP!) are willing to accept that the origin principle can induce a cleansing of national services regulation : where justified by market failures (and not harmonized), derogations can be allowed, other services activities would have to expect the competitive winds of free movement by operators not subject to local restrictions. Since there are no tariffs or quotas in services, which might have been gradually reduced like in goods over decades, this competitive exposure would amount to a potential shock treatment. This shock is amplified by the fact that almost all services have a high labour contents in contrast to (most) goods. And precisely the labour contents led to great fears about East-West competition based on large wage differentials (the Eastern enlargement happened in the same year) and to consequences of the application of the Posted Workers directive to services in the three countries without minimum wage legislation (Germany, Denmark and Sweden). No wonder that the design was undermined in two ways. One little noticed route assumed by lobbyists was to expect the origin principle to stay<sup>29</sup> and assure 'their' sector to be derogated. Many succeeded in doing so, with the taxi sector obtaining a place under (the exception of) transport during the last days before the final vote as a clear example of this tactics. The other way consisted in killing the origin principle itself and seeking for alternatives. There is general agreement that the solution adopted in directive 2006/ 123, of merely restating the free movement of services, is most unsatisfactory as it represents no driving principle of deeper liberalisation of services (the very reason why the Lisbon strategy had it as its top priority) whilst also being inconsistent with lingering derogations to a removed principle (and possibly with case law).

Would MR have been possible and, more important, would it be more effective?

The short answer is that the analogy with goods would suggest considerable problems with the application of the 'equivalence' principle (the second 'leg' of judicial MR, see Figure 1) which would result in a lack of legal certainty combined with unpredictable – but presumably large - demand for further harmonisation. If correct, this would go against the very idea of horizontal liberalisation. The latter was borne after a long history of unwillingness on the part of the EU legislator to engage in systematic services harmonisation for the purpose of making free movement and establishment effective, except for the regulated sectors excluded in the Bolkestein draft. Hence, the explosion of ECJ cases during the 1990s.

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<sup>29</sup> This would have been entirely possible, with relatively minor amendments. See the detailed, slightly revised proposal by the Dutch Social Economic Council in SER, 2005, unanimously supported by both social parties and independents.

Later on, fears about endless battles of other sectoral harmonisation bottled up and the Bolkestein draft drew the logical conclusion to avoid this and go for the origin principle (sound, where restrictions could not be justified anyway), together with a Christmas tree of derogations. The screening of national services laws and the initial derogations would then define a long term harmonisation programme (insofar as justified by objectives), with free movement at least ensured 'outside' these domains.

The principal reason for difficulties about equivalence is that 'risk regulation' justified by asymmetric information is harder to formulate objectively and effectively in case of "credence" goods than in case of "experience" goods, which in turn are a tougher case than "search" goods. When health, safety or environment objectives for goods are at stake, different degrees of risk reduction (i.e. distinct levels of regulatory protection via more or less ambitious objectives) can be fairly rigorously defined, and often even measured, incorporated in performance standards and verified in conformity assessment. This is harder to do for experience goods like a taxi service or a credence good like a service by a lawyer or a medical doctor or a technical consultant. Once levels of regulatory protection via objectives are going to be set in a qualitative fashion, two immediate drawbacks will show up. One is differential interpretation due to being accustomed to certain traditions in various EU countries, the disruption of which generates uncertainty (in particular, because unlike in goods, services tend to be subject to legalistic approaches, which are hard to 'read' by entrepreneurs). The other is even more obvious: qualitative objectives are a standing invitation of vested interests to argue their specific case, if not lobby nationally to maintain their cosy protection one way or the other. Not seldomly is this done by blending public interest aspects (say, consumer or workers' protection) with their own.

Moreover, as noted before, MR did play a role already in the case law and a good deal of that was carried over to the Bolkestein draft, without however going as far as MR in goods. In his survey, Hatzopoulos (2008, pp. 157 – 161) shows that Member States had been condemned by the ECJ numerous times ".. for failing to take into account conditions fulfilled or guarantees offered by services providers in their home state". Not only does this refer to checks and controls carried out by the home state and related to the exercise of the service activity, but also aimed at different purposes.<sup>30</sup>

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<sup>30</sup> Example : The Dutch authorities required special ID cards for security personnel but should have accepted passports or ID cards from the home state. Case C-189/03 in [2004] ECR I-9289.

However, the ECJ has applied this quasi-MR as an element in its proportionality test, much as the disapproval of duplication of testing in the goods sectors in older case law. A corollary of this ECJ assessment is its insistence, time and again, on the duty of Member States to cooperate pro-actively to exchange documents and other information so as to allow free movement of services to be exploited freely by economic operators. The ECJ has left the door open to infringement proceedings against EU countries the authorities of which fail to cooperate effectively.<sup>31</sup> The extensive administrative cooperation provisions in the draft, bolstered further in the final dir. 2006/123, create a kind of governance system – be it weaker than in Reg. 764/2008 - to ensure a due process balancing a recognition of what the home state does with that of the destination state. Meanwhile, the Commission has invested significant efforts, together with the Member States, to do exactly that : setting up networks of national contact points, after an intense and unique screening exercise of national and regional services laws and decrees, as well as a dedicated implementation route (Member States and the Commission in an implementation committee and Commission officials visiting all local implementation task forces repeatedly ) in order to make the most of the quasi MR of mutual verification and administrative cooperation.

Nonetheless, the fact remains that the original draft would have led to a painful dichotomy due to the lack of MR. Ever since the Saeger case<sup>32</sup>, the similarity with (Cassis de Dijon in) goods seems to exist : a Member State can "... not normally prohibit the provision of a service .. lawfully provided in another Member State". This is the first leg of MR, the origin principle. And, as noted, this is accompanied by a kind of quasi MR in some respects. But without a genuine equivalence test of objectives, and given the inherent difficulty of formulating objectives as precisely as under risk regulation of search goods, true MR was apparently regarded as too problematic.<sup>33</sup> The dichotomy that this causes is the following. *Either* the origin rule is applied, thereby disregarding the rule-of-reason derogations, leaving only the treaty derogations : this risks undermining 'justified' regulatory objectives of Member States, something that is precluded under MR.

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<sup>31</sup> The Kapper case ; Case C-476/01 in [2004] ECR I-5205. Note as well that in some fiscal cases the ECJ insists that Member States have a duty to first look into evidence brought by the interested party before imposing a restrictive measure.

<sup>32</sup> Case C-76/90 in [1991] ECR I-4221.

<sup>33</sup> MEP rapporteur Gebhardt has consulted on the MR option.

*Or*, derogations from case law do apply as well, but in the absence of an equivalence test of regulatory objectives (MR), this can be expected to lead to a blockage of free movement: the origin principle would fail to generate free movement and competitive entry in many instances.

## 7. Conclusions

Mutual recognition is a great invention of the EU. However, before it works beyond some obvious instances of disguised protectionism (as the typical cases of Cassis de Dijon, Italian pasta, a Dutch refusal to import certain types of German bread or the French prohibition of aspartam in light-cola, etc.), MR requires considerable refinement. The EU has gradually developed judicial and regulatory MR. The latter, in the forms of the New (and Global) Approach and the new (more horizontal) food legislation after 1985, has been very successful over time. The 2008 Goods package contains what can be held as the completion of a system grown deeper and wider over more than 2 decades, with solid underpinning of mutual trust via accreditation in an EU-wide network and other improvements, not least at the outside EU border. A remarkable, though little known, track in regulatory MR is the prevention of future regulatory barriers from arising in the internal goods market. The combination of an ever more effective approach to existing barriers and an intrusive and targeted pre-emption policy for future ones has effectively spared the single goods market from destructive erosion.

Judicial MR has always remained somewhat problematic. It has worked quite well in the food sector but only very selectively in other areas. Business criticism in the 1990s was often bitter because the legal tradition of basing everything on case law completely missed out on the day-to-day reality in cross-border market access in the EU.<sup>34</sup> Three types of costs were incurred by European business, severely discouraging the exploitation of MR (and hence losing a good deal of the potential benefits for the internal market). Once the Commission began to realize this, it started to complement a steady stream of infringement procedures with the building of MR governance. This was accomplished in a decade via a highly consensual approach. Reg. 764/2008 was packaged together with the betterment of regulatory MR (see above).

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<sup>34</sup> One phrase used being that MR is "a phantom in the court room."

The new governance of judicial MR drastically reduces these costs and gives far-reaching legal certainty, inter alia via a reversal of the burden of proof for non-conformity of goods already allowed on the market in other Member States.

Given the enormous importance of services for the economic prosperity of the EU, the query whether MR could also be usefully applied for the horizontal liberalisation in services is addressed as well. The short answer is that it would be problematic because many services are not search goods, but rather experience or credence goods for which regulatory objectives are harder to formulate in a rigorous risk reduction way. Nevertheless, a kind of weaker quasi MR has been imposed in case law. It has induced efforts of Member States and the Commission, acting closely together so far during the implementation of dir. 2006/123, to build a governance system which to some extent reduces the difficulties often encountered in horizontal services issues. Falling back on the origin principle as in the Bolkestein draft would also have had serious drawbacks, but acceptable solutions could have been found. A future of selected harmonisation combined with 'deep' administrative cooperation between Member States, backed up by case law and simplification of the directive once the 'rendez-vous' clause (2012) is up, should make it possible to finally arrive at a genuine internal services market that works.

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