Mutual Recognition on "Trial": The Long Road to Services Liberalization*

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ABSTRACT

In his 1986 White Paper on completing the single market, Lord Cockfield ailed mutual recognition as the miracle formula for the much needed liberalization of services markets. Twenty years later, the European Union is passing a services directive where the principle of mutual recognition is conspicuously absent, at a time when effective liberalization seems ever more necessary. How do we explain this puzzle? Why has mutual recognition been put on "trial"? We make three interrelated arguments. First, the initial draft directive overlooked the EU's prior experience in this area which is one of "managed" mutual recognition. Secondly, the political context had changed significantly, with enlargement exacerbating the distributional consequences of the adoption of mutual recognition. Thirdly, the final compromise succeeded precisely because it recovers the spirit of the managed mutual recognition, albeit in a mini-

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malist form. Nevertheless, final agreement has come at a price: the symbolic sacrifice of the principle of mutual recognition itself.

KEYWORDS

Liberalization; mutual recognition; services directive; services trade; single market.

INTRODUCTION

The trial of mutual recognition in the EU in the years 2004-2006 is a fascinating story, full of personal and political drama, false accusations and genuine resentment, aggressive grand-standing and painstaking attempts at amicable settlement. The trial was run as much outside as inside the court room in Brussels, with crowds gathering in ever greater numbers to weigh on the final verdict. The trial meant different things to different people: a crucial test for the Commission's liberal agenda as well as for the left's "social Europe"; the promise of a better life for services workers from the East, the threat to a way of life for unions in the West.

Crucially, the first exhibit in the trial was an usurpation of identity: mutual recognition, stripped down to its bare bones, under the label of the "country-of-origin" principle. Paradoxically, this principle would be the source of redemption for some, the source of all evils for others. Supporters of "country-of-origin" conjured up abstruse examples of hindrances to cross-border services deliveries. Are requirements of long cumbersome administrative procedures in order, for example, to fix an elevator across borders proportionate to the task? Is it right to see the arrest of a Slovak tourist guide performing in Prague? By the same token, opponents depicted doomsday scenarios where polish butchers and plumbers would be let loose

in western European markets disregarding the social *acquis* of beleaguered trade unions with phantom firms escaping all regulatory control thanks to a letter-box in the East.

Such polarization came as a surprise to the Commission for whom the application of mutual recognition to services had long been a technocratic tale of trial and error. While it had appeared in the Treaty of Rome only with regards to the professions, Lord Cockfield had hailed mutual recognition in his 1986 White Paper as the miracle formula for the much needed liberalization of services markets across Europe. Twenty years later, however, such liberalization was still wanting even though it had become ever more crucial to foster economic growth in the ailing economies of the old Member states.

This article analyzes the problems associated with integrating services markets via mutual recognition, with particular emphasis on the 2004-2006 negotiations concerning the horizontal, non-sector specific services directive and its progressive evolution away from its original incarnation as the 'Bolkenstein directive'. We make three interrelated arguments.

First, we argue that in the initial phase of the debate, both sides mis-represented the EU's prior experience in this area: the ardent proponents of the country-of-origin principle who argued that this had been the EU approach all along, and its ardent opponents who argued that it was completely new. By failing to admit that the EU had consistently practiced a form of "managed" mutual recognition in the past, in which home-country control is conditioned, partial and monitored, the Commission and the Member States governments contributed to an

extremely polarized situation in which agreement seemed impossible (Nicolaïdis 1993, 1996, 2004).

Second, we argue that the political context had changed significantly in the intervening years, with the politicization of the single market and the greater differences between Member states' regulatory and economic development associated with Eastern enlargement. Fears of regulatory competition and social dumping in the richer Member states which had previously been invoked only to "manage" mutual recognition now led to a political veto.

The emblematic figure of the "polish plumber" captures the challenge faced by the attempt to liberalize in such a context. Given the distributional consequences of the services directive, it was no surprise that unconditional mutual recognition proved unacceptable for many of the "old" Member states. While the discussion focused predominantly on economic gains and losses, behind these stood significant political repercussions for governments given the uncertain implications of the directive for a variety of domestic regulatory bargains. We take the case of Germany to illustrate our argument.

Thirdly, we analyze the final compromise and argue that it succeeded precisely because it recovers the spirit of managed mutual recognition. Nevertheless, the great irony is that it did so by eradicating mutual recognition altogether from the legislative text. By bringing host-country jurisdiction back in – even if in a constrained form – the directive has understandably disappointed the most liberal constituency in the EU especially in the new Member states.

In the following, we start with a discussion of the services freedom laid down in the Treaty, which the services directive aims to realize as well as a discussion of the contrast between trade in services and trade of goods. This is necessary as many of the confusions surrounding the services directive relate to it.

SPECIFICS OF SERVICES TRADE, REGULATION AND LAW

Mutual recognition as a means of creating a common market was recognized first for services in the Treaty of Rome where it was mentioned for professional services and the mutual recognition of diplomas. In spite of this, mutual recognition was only applied to a couple of professions in the 1970s, on the basis of significant prior harmonization. And while the case law concerning judicial recognition of equivalence was developed with regard to goods (Dassonville, Cassis), the European Court of Justice (ECJ) bulked when it came to apply it to services. Indeed, services are considered a "harder case" for liberalization than goods, not only because they are generally more regulated, but because of their mode of delivery which often involves the movement of either service providers or consumers across borders - unless the service is provided electronically. It is often said that services are intangible and invisible – recall the Economist's famous definition that services are that which cannot fall on your foot. One implication is that it can be difficult to separate their production from their consumption, in that value is produced for the consumer at the moment of interaction with the provider. We can draw an analytical distinction between the service delivery and the product itself in the same way as process and product standard are distinguished for goods. But for services almost all

regulations have to do with processes, themselves bound up with home-country rules whether concerning market access (e.g. training requirements for ski instructors), operation (e.g. certain solvency requirements, speed limits), acceptable products (e.g. insurance types), and their distribution (cf. Roth 2002: 16). Thus, host countries usually need to apply their regulations to process standards if they want to affect the quality of the service; but the application of such rule may in turn impede delivery of the service altogether.

This reasoning holds provided that free movement of services can be distinguished from free movement of labour or establishment since the latter two naturally call for host-country control. The core test here – as stated in the Treaties – is temporariness. If a cabinet-maker offers particularly tailored repair services across borders, she profits from the freedom of services, and at least theoretically, from home-country rule; if he does it on a continuous basis with some sort of establishment, it is the freedom of establishment that applies, and thus host-country rule. According to this reasoning, workers posted temporarily would deliver services according to working conditions (pay, training) of their home countries, side-by-side with the very differently regulated workers of the host country. It is easy to see how such an inference could be resisted.

Since the freedom of services targets temporary activities, it did require constraints on the application of host-country regulations to avoid a prohibitive burden, but it also generously provided for exceptions – allowing the host country to invoke the general interest and the likes in order to justify the application of its own rules (Hailbronner and Nachbaur 1992:

112). As with goods, such allowance would of course be subject to the rule of reason (necessity and proportionality test), but services restrictions always seemed to be based on good reason. When it came to labour standards, working conditions and pay, the court clearly allowed "the general interest" to justify host country control (Rush Portuguesa ruling, C-113/89).

The question becomes therefore, to what extent is it desirable and feasible to move from a situation of constrained host-state jurisdiction as is currently the case for all services not covered by sector-specific directives, to a situation closer to mutual recognition as has been the case for trade in goods? Given the prevalence of process standards, it is no surprise that the prospect of generalized mutual recognition raised fears of uncontrolled regulatory arbitrage, even though regulatory competition and the downgrading of standards does not seem to occur in sectors where recognition has already been adopted.

RECURRENT PATTERN: FROM THE 1986 WHITE PAPER TO THE 2006 SERVICES DIRECTIVE

At a time when the "new" character of the current services agenda has been stressed so relentlessly by the media, it seems fascinating to highlight the parallels between Frits Bolkestein and Lord Cockfield in their respective crusade on behalf of mutual recognition. One English, one Dutch, the two commissioners in charge of the single market were both outspoken liberals. Like Bolkenstein 20 years later, Cockfield took to its ultimate logic the single market im-

perative. In his White Paper – endorsed by member states through Delors' Single Act – he picked up on the approach worked out by the Commission since *Cassis de Dijon*, which was to generalize the philosophy of "recognition of equivalence" to the whole of services. But many services fell outside the net of the Single Act.

Then and now: three interrelated logics

By 2000, in spite of the dynamic set in motion by Delors and Cockfield, and while almost every type of services had been touched by one directive or another, the Commission continued to identify numerous barriers and even still nationality requirements. At the turn of the century, the single market was far from complete, calling – again! – for a more radical approach. The familiar pattern can be summed up as an interaction between three logics.

First, the *jurisprudence* of the European Court of Justice which instead of an injunction to recognize, provided a "roadmap" for future legislation. The distinction made in the insurance directives between types of consumers that could or could not withstand the logic of mutual recognition or the 1996 directive on the posting of workers are prominent examples of political translation of the Court's jurisprudence. The Court might have become slightly bolder in the early 2000s than in the early 1980s – proportionality was to be taken seriously – but the same limitations applied (Hatzopoulos and Do 2006).

The second logic is broadly *integrationist*, whereby, usually for exogenous reasons, Heads of States assert the teleological credo of the need to complete the single market, instructing the Commission to make it happen (demand side). As they had instructed Delors in 1984, they

repeated more or less the same message at their 2000 meeting in Lisbon where they set out a strategy for 2010, to make the Union the most competitive region in the world. In both cases, completing the single market was at the core of the agenda. “In 2001 intra-EU exports of services … only represented around 20% of trade in the Internal Market, compared with services’ 53.6% share of GDP” (European Commission 2004: 9). The Commission (supply side) then takes the politicians at their word in fact “upping the ante” by proposing a radical generalization of the Court’s approach in the pursuit of the completion of the single market for services, which is after all what the political masters are asking for.

But then, a third logic kicks in, the properly political process of bargaining, whereby a winning coalition of member states succeeds in watering down the extent of transfer of sovereignty through recognition in order to make liberalization politically acceptable.

The difference between the two period lies both in the salience of such political bargains and in the Commission’s capacity to anticipate them. While Bolkenstein sought to implement his “pure” philosophy directly through a single horizontal directive, Cockfield’s was spelled out separately in the 1986 White Paper and then translated through several dozen sectoral directives (including communication, transport, finance, and the professions) which did not simply enforce mutual recognition. Instead, they reflected subtle and complex bargains struck among regulators who sought to please their political masters by liberalizing for the headlines but complemented recognition with all sorts of caveats (Nicolaïdis 1993, 1996, 2004). Mutual recognition was managed to ensure that regulatory competition not lead to consumers’ confu-

sion and a general downgrading of standards. Managed recognition involved minimum prior harmonization or convergence of standards as with goods, but also other attributes, like diminishing the automaticity of access to host-country markets by granting residual host-country control, reducing its scope in various ways and setting up mechanisms of ex-post guarantees and monitoring (indeed, such "tricks" to attenuate the import of mutual recognition had been used since the 1960s). In short, in 1986-1992, the monopoly of initiative of the Commission was not used to carry out the radical agenda as such but to fine-tune its limits.

In contrast, oblivious to the political nature of services regulation even when responding to the mandate of politicians, the Prodi Commission refused to make concessions to political expediency. In December 2000 it proposed a comprehensive strategy to complete the single market, including seven new directives. Most importantly, DG single market was charged with drawing up an inventory of all remaining barriers to services, delivered in 2002 to the Council which then requested action. More than happy to oblige, Frits Bolkestein drafted the most radical directive ever to address the single market for services, in all those areas where specific measures have not yet been taken. Given that sector-specific attempts at building the single market for services had had their limitations, such a horizontal approach was in fact consensual across EU institutions and Member states. Bolkestein consulted with national ministries over a period of two years and national bureaucrats seemed to be more or less on his wavelength.

So by early 2004 the draft "Bolkestein directive" was born. Little did its creator suspect that it would achieve such fame and disrepute. What was so different this time around? To what extent did the directive depart from the prior step-by-step logic of managed mutual recognition adopted earlier by the Commission?

A bold directive

To start with, the *scope* of the draft directive was extremely broad, targeting both the freedom of establishment and the freedom of services for those not previously covered by other directives. The directive exempted only lotteries for commercial services. Critically, the directive covered services of a *general economic interest*, including health and social services outside direct state provisions– while genuinely *general interest services*, which are delivered without any profit interest (e.g. education, cultural activities), were left out.

Moreover, scope was also made ambiguous with regards to the relationship between the draft directive and *existing European law for services*, concerning financial services, utilities, services of general economic interest, posted workers, professions. Neither did the draft apply to these sectors, nor did it exempt them; instead it "complements existing services laws", leaving room for all sorts of forecasts concerning potential conflicts.

Most importantly, the very core of the directive is the idea that the only way to remedy the petty bureaucratic impediments imposed by host countries is to make access to markets across borders as easy and *automatic* as possible, which in turn would require to fully enforce the principle of "country-of-origin" or home-country control. As a result, the host country would

be restricted from enforcing its own laws or practices to justifications linked to “public order, public health, and public safety” - in other words narrowly defined public-interest rule which did not even encompass the ‘rule of reason exceptions’ recognized by the Court (Drijber 2004: 3).

Relatedly, the directive also tackled the issue of *applicable contract law*. Home-country rules were only relevant for business rather than consumers for whom international private law would stay applicable. Such introduction of home-country control without detailed specifications as to its scope and prior conditions led to much criticism as serious conflicts with Rome I and II was feared (Basedow 2004).

To be fair, the directive did not call for jurisdiction of the country-of-origin across the board. Obviously, greater *freedom of establishment* will always allow for host-state territorial control; but at least, the directive required host states to create a one-stop-shop with exclusive administrative responsibility (Art. 6) in order to do away with restrictions on establishment which cannot be justified by the principle of proportionality.

More to the point, the most controversial aspects of the directive had to do with the conditions under which workers providing cross-border services - such as butchers, plumbers or construction workers – would be treated. Theoretically, such movement falls under the *1996 posted-workers directive* (96/71/EC) and its application of host labour law and wages. However, the draft foresaw the easing of some restrictions, like the need to carry papers for local controls in the host country and the obligation to appoint a national representative (Art. 24).

Such provisions would make it more difficult for host countries to know whether posted workers complied with their legal provisions, thus bringing even the area of labour movement in the ambit of a recognition through the backdoor.

Open questions related also to the precise definition of the *temporary* nature of service provision which determines in turn whether a worker is a service provider or a migrant. The directive left this open as it is difficult to set limits relevant across the board. For instance, seasonal services such as skiing instruction would need to be treated differently from other activities.[1] Given the planned extent of pure recognition a precise definition of temporariness would have been key to preventing a situation of "anything goes."

Finally, while no concession was made to *prior harmonization*, the directive did include the obligation of national authorities to cooperate with each other, thus including *ex-post safeguards*. Thereby, since freedom of services often leads to situations where host countries have to verify the actual respect of home rule, the directive sought to improve their capacity to do so by requiring information from home-country authorities as to the legality of companies posting workers for instance.

Perhaps such a sweeping horizontal directive targeting very different conditions in different services sectors was bound to be contentious in the traditional political economy of the EU where constituencies naturally resist reforms which may question their rents. However, to understand the unprecedented escalation observed in the resistance, we need to examine more

closely the changing context and changing frames of liberalization in the late 1990s, early 2000s.

CHANGING CONTEXT AND CHANGING FRAMES FOR LIBERALIZATION

There is little doubt that the EU's biggest enlargement since its inception conditioned the reactions to the services proposal. Simply put, the level of differences in national regulatory and legal settings was simply becoming too great to sustain the permissive consensus on liberalization that had (more or less) prevailed until then. The German case can help us understand how this general state of affairs translated into specific resistance to the directive. As the largest Member state, neighbouring the new Member states, as well as plagued with high unemployment, high wages but no minimum wage, Germany is bound to be a special target for low-cost services exports. Perhaps Germany could be considered an outlier. But while especially vulnerable, it was also a harbinger of things to come.

Changed context: An influx of Eastern Europeans

A few months after the 2004 enlargement, Germany was surprised by the extent to which East Europeans put pressure on its national job market. This came unexpectedly as it had joined most other Member states (with the exception of the UK, Ireland and Sweden) in using the transitory arrangement (2+3+2 years) restricting the freedom of labour for the new Member states (excluding Cyprus and Malta). In addition, Germany had negotiated a transitory regime for the freedom of services, exempting construction services, cleaning, and inner decoration. Arguably, these exemptions are precisely in those areas where East Europeans could profit

least from existing wage differentials as construction is a sector where a minimum wage applies. In all other sectors, workers can come in temporarily under the services freedom – interpreted by the German authorities as up to one year – and replace German workers for the wages of their home country, given that there is no general minimum wage (Christen 2004; Temming 2005).

As a result, enlargement has turned sways of public opinion against the *existing* freedom of services provisions. Germans have been laid off on a large scale from slaughterhouses bringing in personnel "from the east" working for little money under deplorable conditions (in some cases, wages are only 2-3 Euro/h and daily working time is up to 16 hours). The responsible trade union spoke of 26.000 lost jobs or one third of all employees in the sector being replaced by East Europeans.[2] The legal situation is complicated as East Europeans can come in under a combination of host and home provisions, to which illegal activities are added. Moreover, under the freedom of establishment, East Europeans with lower labour standards expectations face no restrictions. (FAZ 10.9.2005, p. 16). No wonder that the prospect of further liberalization through the services directive was all but welcome (Hamburger Abendblatt 26.2.2005, p. 23).

To make matters worse, domestic reforms had increased Germany's vulnerability with the significant liberalization in 2004 of the crafts law which made it easier to establish a company even with only one self-employed person. Until then, the 1953 crafts law restricted establishment to individuals having a "Meisterbrief", i.e. a master craftsman's diploma involving ex-

pensive and long-term training. East Europeans constituted the bulk of those taking advantage of the new law (265 out of 391 new tilers after the reform in Munich). This is not surprising since no specific wage and social security obligations exist for self-employed persons. At the same time, stories started to emerge of East European craftsmen getting around the requirement for a "permanent establishment with sufficient space" by sharing a single address, or illegally claiming establishment while exclusively or predominantly working for a single customer (Stuttgarter Zeitung 12.4.2005, p. 1; General-Anzeiger 14.5.2005, p. 3).

Short of establishment, the posted-workers directive prescribes German labour conditions for all branches. However, with no general minimum wage, there are no wage restrictions on posted workers. The posting company is only required by the law to discharge social security expenses and be active in the home country – a safeguard against mere "letter-box companies". Moreover, posted workers cannot fully be integrated in the German company's work process; otherwise social security would have to be paid in Germany (Fleischwirtschaft 12.5.2005, p. 10).

Consequently, a host of opportunities arise for illegal activities: Are workers really temporary? What does it mean to apply the working conditions of the host country? What is a reasonable pay when no host state minimum wage exists? Is the home company real and active or merely established for posting workers? What is the criterion – e.g. what percentage of company employers must actually work in Poland, representing what percentage of the annual turnover? And does the company really pay social security? How would the host country

know? Can it trust controls carried on in the home country? Indeed if the home country itself suffers from high unemployment rates, what is its incentive for playing by the rules?

Changing frames: Anti-globalization… Europe's way

By the time the services directive came to the attention of the European media, such prior questions had neither been resolved in Germany nor in the rest of Europe. With slow growth in Europe and the GDP share of services, the renewed attempt of the Commission to tackle services liberalization could have been seen as an imperative. Indeed, supporters of the draft directive easily produced numerous examples of abstruse hindrances to the services freedom, which were clear violations of Treaty obligations. But the arguments of their opponents were put in even starker terms. There seemed to be no meeting point between the two worldviews.

To simplify, we could argue that two broad trends in Europe provided the backdrop for the mounting resistance against what came to be called the "Frankenstein directive". The first was part of a more global *politicization* of trade, the European version of anti- or alter-globalization, or the idea of *Europeanization as globalization*. The mobilization of fears in the broader public was based on the now familiar notion that these sources of comparative advantage across countries are not all born equal and that to extend liberalization to countries with significantly lower GDP per capita allowed them to exploit "unfair" advantage. This move from free trade to "fair trade" reached a critical turning point with the 2005 bra war against Chinese import.

This argument took on special force in the case of the services directive where instead of social dumping *at a distance*, we have what could be called *face-to-face* social dumping. Thus a principle that had been widely used in the EU to complete the single market – namely that of country-of-origin – now made a re-appearance on the European public sphere as the Trojan horse of "unfair competition" and "social dumping", in a way that the public could indeed comprehend: people coming to work here will carry their home rule on their shoulders so to speak, like double agents operating in the European social space. Citizens from the new members were not fellow Europeans but *strangers within* objectified as a group through the very real metaphor of the *polish plumber* (or butcher in Germany). – No matter that polish plumbers on the French soil were very few and far between.

The case for the defense argued that social dumping should be no concern given that the posting of workers directive largely prescribed host-country rules. But as the German case illustrates, the truth is more ambiguous as only minimum wages – but not collective wage agreements – can be made mandatory. Like Germany, Scandinavian countries had come under pressure, as the ECJ does not treat minimum wages and collective agreements in the same way although they are institutional equivalents (Woolfson and Sommers 2006).

The second general trend associated with the resistance to the draft directive and its core suspect, the country-of-origin principle, has to do with *ideologization*. While there had been debates for a long time about the liberal bias of the single market and the need for social flanking measures, only in recent times has free trade come to be associated with deregulation and

a “neo-liberal agenda”. It may be true that the prior phases of building the single market had demonstrated that liberalization most often went with re-regulation, but there is no denying that the draft directive was likely to have a significant deregulatory impact, as Commissioner Bolkestein himself stressed:

“Some of the national restrictions are archaic, overly burdensome and break EU law. Those have simply got to go. A much longer list of differing national rules needs sweeping regulatory reform.”[3]

This kind of statement of course reinforced the social resistance to what was seen as the disembeddedness of global markets. Opposition to the directive became a rallying cry for the left, for unions and groups like ATTAC. It was amply used in the French referendum campaign to illustrate the drift to a neo-liberal Europe, regardless of the fact that the directive could be passed under the existing Treaties. In this ideological context, host-country rules were defended not as *protectionist* nor even as social *protection* for the workers of the West but as an extended hand to the workers of the East in a grand gesture of solidarity to guarantee better working conditions for them, too. The polish plumber should be denied home-country rule for his own good, as otherwise Poland would soon suffer from wage differentials with Ukrainia, a reason invoked by Solidarność to oppose the services directive.

In other words, the opponents stressed the unique qualities of services trade and denied the analogy to goods. Services trade has to do with the movement of people they stressed. It is less objectionable to sell shoes in the same shop which were made under very different condi-

tions in Europe and in East Asia, than to have service providers from different countries working alongside each other while subject to different rules and pay. Whereas a person working in a shoe factory in the Far East can at least – however poorly – live from her wages there, posted workers delivering services on a temporary basis could not easily live where they worked under home-country wages (cf. Streeck 2000).

Moreover, the old arguments against mutual recognition as a burden for consumers and not just as a guarantee of choice reappeared in this context. The legal certainty obtained for services providers when operating under home-country rules would come at the cost of legal uncertainty for host-country consumers who might not be aware that a service was provided to them under an unfamiliar set of rules. The transaction costs of adapting to several legal systems would be shifted from service providers to the consumers.

In sum, after the liberalization of the utilities and of financial markets as well as changes in corporate governance with the takeover directive, the services directive was perceived as the final blow to the European social model and the advent of Anglo-Saxon pure capitalism (Höpner and Schäfer 2007). Much of the contention was caused by the uncertain implications of the directive. Would mutual recognition imply that a Dutch architect planning and building a house in Germany would do so according to Dutch building laws? Could a Polish cleaning woman working in Germany use detergents not certified on the German market (Hamburger Abendblatt 26.2.2005, p. 23)? Would a British bus driver working in Germany drive on the

left? While the last question is obviously absurd, it illustrates *a contrario* the logic of the prosecution.

In contrast, those on the defense side were at pains to stress analogies with goods and the long history of transferring mutual recognition from goods to services. The Commission's impact assessment stressed the cost of non-"services Europe" in terms of growth and employment potential and reiterated the absurdity of the barriers targeted by the directive (European Commission 2004). Proponents referred to France where service workers from other Member states have to register eight days in advance, making it impossible to cross the border and to repair an elevator; to Belgium, where a painter has to transport his ladder in a special car, usually not owned by EU-foreigners; to southern European Member states where tourist guides have to take special training, making it difficult for tourist groups to enter with their own guide; or the need for service providers everywhere around Europe to present officially translated documents and certificates.

Supporters moreover stressed that small and medium-sized enterprises suffer most from the status quo, while large companies could acquire the necessary legal assistance to adapt to host-country rules. And since cross-border services delivery was often a necessary first step for a cross-border establishment, allowing to test demand, such investment was impeded, too. Against the fears of social dumping, they argued that all would benefit in letting uncompetitive services sectors disappear – especially low-cost services sectors in high-wage countries. Liberalization would ease the export of highly specialized services to Eastern members whose

markets were growing fast. Moreover, the pressure on low-skill services jobs in countries like Germany was not due to European but to domestic political processes. Germany could affect face-to-face social dumping simply by opting for a minimum wage. But could it have its cake and eat it, too? No one seemed to complain about the meat companies from the Netherlands and Denmark relocating to Germany, in order to profit from East European wages.[4]

More generally, supporters responded to the views of Europeanization as globalization with a vision of Europeanization as "non discrimination". They stressed the desirability of globalization "with a human face" (even that of a polish plumber!), the desire of most human beings to return to "home sweet home" and the need to convey solidarity through open markets rather than harmonization.

Supporters of the directive however failed to mobilize on a par with its opponents. While the unions mounted protest after protest, consumers or employers' associations did not emphasize their interest in liberalization. In the Commission, the single market Commissioner McCreevy similarly opted for a low profile, leaving it largely to President Barroso to argue in favour of the directive. The centrality of the directive for the Lisbon-Agenda was thus not sufficiently underlined (FTD 17.2.2006, p. 29). Perhaps in any case, the directive in its original form was doomed once its opponents had successfully reframed the issues at stake.

NEGOTIATION AND COMPROMISE: MUTUAL RECOGNITION SACRIFICED

Opposition against the directive mounted throughout 2004-2005, coinciding with the ratification campaign for the constitutional Treaty. In view of the calls for "death to the services directive", it may seem like a miracle that the European Parliament managed to vote with an overwhelming majority for a revised draft, upon which the Council issued its common position in July 2006. Indeed, for the first time so visibly in the context of the single market, the locus where political bargains had been struck had changed from the Council to the European Parliament. However, in order to reach compromise the letter, if not unambiguously the spirit of mutual recognition had been sacrificed.

How did Member of European Parliament (MEP) Evelyn Gebhardt – a German social democrat and rapporteur of the single-market committee – succeed? In a nutshell, through politicization, or the self-conscious adaptation of a hitherto technical exercise to the new political context in which it was taking place. In view of the contention surrounding the home-country principle, this meant finding a compromise between the two biggest political parties of the parliament, the European Socialists (PES) and the European People's Party (EPP). At first, the compromise came in the form of a safety clause allowing Member states in certain cases not to apply the principle. But one week before the plenary vote, the European Parliament (EP) protagonists decided to abolish the home-country principle altogether.

To be sure, Evelyn Gebhardt and her colleagues had tried for a while to replace the country-of-origin principle with mutual recognition as the core principle for the directive. She was at

pains to explain that the two had to be differentiated radically. *Cassis*, she stressed was also about allowing the host country to impose its own mandatory requirements. Mutual recognition was a conditional process and did not have the either-or character of the country-of-origin principle. In Drijber's words:

"Under the Court's rulings, the law of the host state must be 'disapplied' to incoming services in so far as its application would give rise to an unjustified restriction of free trade. In other word, mutual recognition is a conditional obligation because the host state may always try to justify a restrictive means. By contrast, the country-of-origin principle works like a rule of conflict. It sets aside the law of the host state, including rules that are compatible with the Treaty. Mutual recognition becomes an unconditional obligation. The Directive therefore goes much further than the case law" (Drijber 2004: 3f.).

Thus, by prescribing aloud home-country control, the draft had gone much beyond the services freedom and its interpretation (Albath and Giesler 2006: 38f.; Schlichting and Spelten 2005: 239). In contrast, mutual recognition as understood by Gebhardt was above all an ongoing *process* of political negotiations where the burden of proof would still be on the home state to show the equivalence of its rules.

In other words, the contrast was one between the unconditional and systematic adoption of the country-of-origin principle on one hand and what we described above as managed mutual recognition on the other hand. Perhaps by insisting on the virtues of mutual recognition as opposed to the (unconditional) country-of-origin principle, the MEPs believed for a while that

semantics matter and that the connotation of “recognition” would be more politically correct to the broader public. But given the extent of opposition, the term ‘mutual recognition’ could not be rescued.

Instead, the final compromise of November 2006 (Directive 2006/123/EC**),** which built on the Parliament’s first reading of February and a Council compromise of May, refrained from moving beyond the jurisprudence of the Court. Depending on expectations, it can be read alternatively as an insignificant gloss on the status-quo ante or as putting in place the first steps of a highly managed form of mutual recognition.

Accordingly, where is the balance struck on *automaticity* of access? The compromise focuses on the obligation to enable the freedom of services through *non-discrimination* – a minimalist approach which of course in its extreme interpretation could eventually be regarded as an injunction of recognition. For now, the host country has to ensure that service providers have “free access to and free exercise of the service activity within its territory” (Art. 16) but it remains in control of what happens on its territory. For instance, recital 87 reads “this Directive should not affect the right for the Member state where the service is provided to determine the existence of an employment relationship and the distinction between self-employed persons and employed persons, including “false self-employed persons””. The burden of proof clearly stays in favour of host country rule.

However, the move back to the host country’s jurisdiction is coupled with a long list of restrictions on the measures they can impose, which, in good ECJ parlance must be necessary

and proportional. It is prohibited to request authorization, registration, identification or establishment as well as to prescribe certain materials and tools for service provision (Art. 16). And the socialists failed, to allow for host-state measures justified by "consumer interests and social policy reasons" (FTD 17.2.2006, p. 9). Under the "managed recognition" reading, the prohibition to impose these types of host-country rules does imply that home-country rules are valid *in such cases*, and that the directive helps authorities of both host and home countries to control enforcement of their own rules wherever the service provision takes place.

As to applicable *scope*, the directive remains horizontal in nature. But Art. 2 excludes many of the services which were particularly contentious, such as all health services, public transport, social, and security services, temporary work agencies, gambling and lotteries, postal services, electricity, gas, water, waste, audiovisual services, electronic communication, financial and legal services. Moreover, facilitations foreseen for the posted-workers directive were deleted. This was much against the interest of the East European Member states, who had felt discriminated against by the requirements of this directive. In order, to compensate, the Commission has started an assessment of the implementation of the directive in the Member states (FTD 9.2.2006, p. 9; 10.2.2006, p. 11).

Moreover, the parliament introduced in the directive a call for the Commission to propose further *harmonization* measures. Other original provisions were kept, such as the requirement of host countries to create a one-stop shop to facilitate the freedom of establishment, the need

to abolish rules implying disproportionate burdens, and the requirement of the home- and host-country authorities to improve cooperation and information flows.

The House of Lords European Union Committee spoke in favour of the directive:

"We are persuaded that the list of exclusions and derogations are less daunting than they might seem and that the revised draft Directive covers a substantial part of the services sector such that it can make a useful contribution to the growth of cross-border services provision within the EU" (House of Lords 2006: 19).

The Commission had come to accept that the services market would have to be liberalized by less radical means and made clear that it would back a compromise rather than use its right to withdraw the proposal. Commissioner McCreevy also noted in this context that criticism of the compromise was hypocrisy given that the employers associations had hardly supported the directive when the unions mounted their protests (FAZ 22.2.2006, p. 12). In proposing small amendments, the Commission's philosophy seemed to be to try to save whatever was possible from the spirit of recognition. It resisted the parliament's attempt to get rid of the mutual evaluation scheme between regulators which would increase the scrutiny on host states seeking to retain arbitrary measures. Hence the Commission used a communication published just before the passing of the Directive ("Guidance on the posting of workers in the framework of the provision of services"[5]) to reintroduce two of the administrative means often used by host states and prohibited in the early draft under article 24 (obtaining an authorisation form, having a representative in the territory of the host state). In terms of scope, it insisted on keeping

notaries under the directive, at least for some of their activities – a classic disaggregation technique familiar to prior managed mutual recognition exercises. These were on the whole minor points, as the Commission ultimately rallied to the EP's sacrifice of mutual recognition. The final version of the directive was adopted by the Council in December 2006 with abstentions from Lithuania and Belgium, thus avoiding a persistent conflict pitting new and (a majority of) old Member States. Such a conflict had seemed likely αfter Parliament's first reading, since many East European MEPs had voted against the initial compromise. Moreover, there had been rumors that their governments were trying to organize a blocking minority in the Council, encouraged by the fact that the UK, Spain, Poland, the Czech Republic, the Netherlands and Hungary had spoken out for a more liberal solution (FAZ 11.3.2006, p. 1, 11).

CONCLUSION

If the recourse to mutual recognition has long been considered as a path of least resistance, "easier than harmonization," we can no longer doubt its contentious character. While European integration is often criticized for taking place behind the back of the public, the court – like drama which surrounded the infamous "Bolkestein directive" between 2004 and 2006 demonstrates mutual recognition's highly political nature, if at least occasionally. We made three interrelated arguments, on the radical strategies of the respective actors, the changing political context and the character of the final compromise. The first two concern the discon-

nection between chosen institutional strategies and a changing political context which led to extreme polarization of the issue. With hindsight, we believe that the Commission made a political mistake in departing from its experience with managed mutual recognition and pressing for a rather radical form of recognition across the board. Given the lack of progress in the targeted sectors and the economic benefits at stake, such a change in strategy was understandable. But given the public unease surrounding both enlargement and globalization (or simply "competition") the Commission might have anticipated resistance.

The case for the defense is compelling. Services are indeed a challenging object of trade liberalization, often involving as they do the movement of people as well as highly regulated sectors of the economy. Extraterritorial tensions are bound to accompany the kind of recognition necessary to ensure a market "without borders": clients unfamiliar with the foreign rules governing their services providers; employees in the same workplace for companies regulated in different countries; authorities of the host country having to verify the application of home rules but constrained in doing so; host-country rules which still apply but need to be enforced by home-country authorities where companies are located. The original directive would have cut the Gordian knot.

The last part of our argument has to do with the compromise that was finally struck in the fall of 2006. First and foremost, we must highlight a fundamental political shift, namely the new role of the EP is serving as the locus for such compromise-crafting politics. On the substance, we have shown how, unfortunately, the EP had to formally sacrifice mutual recognition at the

altar of crude criticism which failed to understand that such recognition could be managed to address the extraterritorial tensions inherent in trade in services. To some extent, this minimalist result can be seen as the inevitable consequence of the trust dilemma associated with recognition (Nicolaïdis 2007). The compromise eases the fears stemming from lack of trust but its sustainability is predicated on some level of trust nevertheless.

This dilemma in turn will affect the impact of the services directive. Many observers in the EU legal community believe that by emphasizing the rights of the host country, the directive falls behind the case law of the ECJ (Editorial Comments 2006). Others would say that by strictly circumscribing such rights, the directive will allow for a comprehensive assessment of all domestic rules concerning the access to, or exercise of services activities across the EU. In fact we argue, the actual impact of the directive on the ground will depend on three concurrent factors – for each trust plays a crucial role, whether between regulators, courts or indeed the citizens of Europe.

First, it will depend on whether there will be a genuine commitment on the part of the regulatory authorities of member states – acting as host states – to refrain from exploiting their remaining authority under the directive and abide by the spirit of the “rule of reason”. This commitment in turn will depend on whether they learn to trust their home-state counterparts, whether “fraud stories” continue to make the headlines and whether labour-market pressures remain politically manageable.

Second, there is no doubt that the directive leaves the door wide open for judicial activism on the part of the ECJ, an opening that can be used more or less wisely. Thus, the impact of the directive will depend on adequate enforcement of both host- and home-country obligations by the Commission and the Court, including soft enforcement through the mutual evaluation process. In doing so these actors need to engage with great political sensitivity with the determination of which host-states requirements are legitimate – such as whether collective agreements can be considered as functional equivalent to minimum wages.

Finally, the fate of liberalization in the EU will depend on the evolution of the political culture of activists, unions and the broader public towards a greater understanding of the spirit of mutual recognition as a process of managing on-going differences and negotiating their tolerable limit. Mutual recognition is a demanding form of transnational governance which seems more acceptable to states and their publics when they perceive it as a form of cooperation rather than competition (Nicolaïdis and Shaffer 2005; Schmidt 2007). And yet, if today's challenge for Europeans is no longer just about the single market but also about the kind of political Union they want to share, the latter must build on the former and the link long established in the Union – albeit still contested – between free movement, borderlessness, extraterritorial law, trust and recognition.

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NOTES

[1] Interview information, DG internal market, September 2005.

[2] FTD 9.2.2005, p.27. Der Spiegel 7/2005, p. 32-35.

[3] Rapid press release IP/04/37, 13.1.2004.

[4] Lebensmittel Zeitung 1.7.2005, p. 37; 22.4.2005.

[5] COM/2006/0159 final.

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