THE LEGAL TOOLBOX FOR REGIONAL INTEGRATION: A LEGAL ANALYSIS FROM AN INTERDISCIPLINARY PERSPECTIVE

A Contribution to the ELSNIT Conference (Barcelona, 26th and 27th of October)

(Work in progress, subject to substantive and linguistic revisions. Please do not quote without consent of the author)

Ramon Torrent
Professor of Political Economy at the University of Barcelona (UB)
Coordinator of the International Chair WTO/Regional Integration (UB-UAM)
Former director of external economic relations in the
Legal Service of the EU Council

Introduction

This paper develops and applies a part of the analytical framework for Regional Integration conceived in the context of a collective research project designed and implemented by the IADB's Trade and Integration Department. A summary of the study was published (Torrent, 2003) in Devlin, Estevadeordal (2003). This analytical framework has already been applied to MERCOSUR - Bouzas, Motta Veiga, Torrent (2003) and Torrent (2006)-.

The paper deals only with one aspect of that analytical framework, the one relating to the instruments of Regional Integration. Therefore, it does not deal with the other three aspects: preconditions, objectives and dimensions. And, as far as the instruments of Regional Integration are concerned, it only discusses one of them, rules (from the threefold perspective of their type, the techniques used for their enactment and the techniques for the definition of the scope of the obligations[1]). From this perspective, the paper generalizes an approach that has already been applied in Torrent (2007) to the distinction between movements of capitals and right of establishment in the European Integration process.

The paper focuses more on the nature of regional economic integration (REI) processes than on their economic consequences. This nature is defined essentially by the legal instruments that support and provide the framework for each process (keeping in mind that the same law can lead to different practices). Therefore, the paper relies heavily on legal analysis of primary sources (provisions of the Treaties and case-law). However, the underlying approach is interdisciplinary (as was the original study for the IADB, in particular the part referring to the different "dimensions" of Regional Integration).

Section I summarizes very briefly the approach to the analysis of regional Integration that underlies the whole paper. Section II develops the distinctions between the three main types of rules, the two techniques used for their enactment and the two techniques for the definition of the scope of obligations. Section III applies these distinctions to different areas covered by Regional Integration; the perspective of this section is comparative, even if the main reference is that of the European Community Treaty. Section IV deepens these distinctions in a particular area of very great economic and political significance (maybe the more important at present in the context of European integration): the legal regime of foreign investment. A section of Conclusions ends the paper.

The paper has two main objectives. The first is that of providing analytical clarity and sharpness in a field of study too mudded, in my opinion, by verbalism and routine repetition of empty or confused ideas. The second is that of contributing to a better use of the toolbox for Regional Integration by policymakers.

[1] The third distinction was absent in the original study for the IABD as well as in the bibliography quoted in the preceding paragraph.

I.- The approach to the analysis of Regional Integration. The Instruments of Regional Integration

The approach

Regional integration is sometimes presented as a unidirectional process, proceeding in stages from the creation of a free trade area to wider and deeper forms of integration. This approach is very often presented in terms of Balassa's stages of Integration (Balassa, 1961), even if (not always) a caveat is introduced in the sense that the stages are an analytical device and must not be taken as successive. Even with the caveat, Balassa's stages are very misleading and contradicted by important empirical evidence. Three examples suffice to prove it:

- The European Economic Area is a rather well integrated common or interior market (as well integrated, in the areas covered, as the internal market of the European Community and its Member States), but it completely skips any attempt to build a Customs Area and is an incomplete Free Trade Area because it does not include trade liberalization in agricultural goods (nor taxation).
- NAFTA includes much more elements of a common market than MERCOSUR (for example as concerns investments, including common rules on protection) but it has never attempted to build a Customs Union.
- If one compares NAFTA with the European Integration process, one discovers that both have elements of a common market (in particular in the area of services and investments –and much deeper in NAFTA than in the European process in an area as sensitive as protection of investments[2]-) but are very different as Integration processes.

I apply a different approach: regional integration follows various paths that may lead in different directions, even if these paths all share some common elements. REI aims to mold social and economic *preconditions* in order to reach its *objectives* (different in each process) using certain *instruments*. Its development can be analyzed in terms of different *dimensions*, allowing for the establishment of a typology of regional integration processes. This is the framework developed, as already mentioned, in Torrent (2003). I concentrate now in one of these four aspects: the instruments.

The Instruments of Regional Economic Integration (REI)

Regional integration is a common endeavor of a plurality of states that requires them to use the instruments available in order to influence social and economic reality. These instruments can be initially classified in three categories: *legislation (rules)*; *public activit*ies (including subsidizing specific economic activities carried out by private operators); and *income redistribution through budgetary transfers*. As REI processes are an international phenomenon, they also make use of the traditional *diplomatic instruments* of dialog and cooperation; they would constitute a fourth category of instruments. For analytical purposes, these instruments must be neatly differentiated from the techniques used to create and apply them and the institutional arrangements used to guarantee their adequate implementation. The subject matter of the instruments

[2] It should be recalled that there is not a single line of Community law on this topic.

defines the content of regional integration; techniques and institutional arrangements affect its strength and dynamism, but not its content.

The following example highlights this distinction. Both the North American Free Trade Agreement (NAFTA) and the European process deal with government procurement by enacting rules. Although the instrument (the rules) is similar and affects recipients (public administrations and private operators) of the norms in a similar manner, the technique used is completely different. NAFTA inserts the rules once and for all in the constitutive treaty; the European process gradually defines rules through a specialized organization. The institutional arrangements (regional institution's role and judicial control) that guarantee the implementation of the rules are also different.

Regional Rules

Regional rules can cover any social and economic situation. From an analytical perspective, it is best to analyze the subject-matter of the rules under the heading of content rather than under instruments for regional integration. The analysis of rules as instruments must relate to the three main approaches (or instrumental ways) of international rules for promoting integration. The first is to impose obligations on liberalization and access to markets. The second is to impose certain obligations of nondiscrimination on the legal framework applicable to transactions and operations covered by the agreements—basically most-favored-nation (MFN) status or national treatment (NT) obligations—while leaving domestic legislation intact. The third is to create uniform legislation establishing a common legal framework for transactions and operations covered by the agreement.

The discussion of this in the following sections constitutes the bulk of this paper; therefore, I leave the distinction here now.

Public Activities

States do more than just enact and implement general legislation. For example, they also finance and manage public services like education, build physical infrastructure, and subsidize specific economic activities. I refer to these as public activities and not as policies because policies can also be implemented exclusively through general rules (on environment, social and labor standards, or education, for example).

The same distinction applies at the regional level. Public activities can play a relevant role in some regional integration schemes. Some analysts, including myself, would argue that some regional public activity must be carried out in order to avoid regional integration becoming simply a politically correct remake of market liberalization. Here again, the subject matter for these activities fits best under contents. What must be emphasized under instruments is that such activities may be needed in order to enact liberalizing rules. The European Community's Common Agricultural Policy is the main example of this.

In the 1950s, when the European Community Treaty was negotiated, agriculture posed two major problems as a sector. First, national budgets heavily subsidized it, and this would create huge distortions of competition if intrazone trade were liberalized. Second,

public intervention was linked to the existence of producer organizations and systems of price controls that constituted a clear infringement of norms on the principles of free competition and antitrust. The alternatives were either to exclude agriculture from the scope of the treaties or to bring the issue as part of the common policies. Member states chose to create a specific set of common rules for agricultural markets that would be inconceivable outside the realm of agriculture. Throughout the history of the Common Agricultural Policy, these rules have involved price controls, public purchases, and buffer stocks, as well as cartels with ceilings on production and penalties for exceeding them.

Leaving aside their merits in terms of economic policy, public activities can have very positive effects on the integration process. I shall not refer to the impact of creating powerful sector lobbies in favor of regional action, because critics can neutralize this effect. I refer here to the definition and management of such policies, which keeps regional integration going even in periods of stagnation, and to the fact that, through these policies, it becomes clear that regional integration is about real economic life and not simply about politics.

Income Redistribution through Budgetary Transfers

All public activities may affect income distribution. Income redistribution becomes a specific regional instrument when it targets specific categories of beneficiaries defined in terms of their income or some other broad economic characteristic. This instrument is typically European[3].

Internally, an embryonic income redistribution policy based on personal criteria dates back to the 1950s (the social fund). But this instrument only became really meaningful (also in budgetary terms) in the 1980s and 1990s when it included the comparative situation of geographically defined collectives, firstly specific areas within member states (structural funds), and finally whole countries (cohesion fund). Externally, the first round of European Community agreements with Mediterranean countries in the 1970s and 1980s included budgetary commitments. Later on, this practice was abandoned and foreign aid was taken out of the agreements (except for the African, Caribbean, and Pacific [ACP] states), and the European Community dealt with it autonomously.

Diplomatic Instruments

As an international phenomenon, regional integration relies on the typical international diplomatic instruments of dialog and cooperation. Their use may promote the emergence of a proper regional policy (implemented through legislation or public activities), but this is not necessarily or commonly the case.

These instruments are diplomatic in origin, and extend to all other areas covered by each process, in particular the economic areas. This development goes beyond regional integration, as the number of international forums on all areas of economic, social, and political life has multiplied. Their effects on integration are greatly enhanced when they are able to effectively involve social and economic actors, in particular in businesses,

[3] Maybe the FOCEM created in MERCOSUR's framework will become a second example. It is too early to judge it.

promoting exchanges and common activities among them. This was one of the significant differences between the negotiations for the Free Trade Area of the Americas and the negotiations between the European Union and Mercosur. In the first case, these actors were effectively involved (and this involvement probably contributed to the rapid negotiation of some bilateral agreements when the FTAA negotiations definitively stagnated) while, in the second case, they were not.

II.- The legal toolbox of Regional Integration: Three types of rules, two techniques for their enactment and two techniques in order to define the scope of the obligations

The three types of rules

As I have just said, the analysis of rules as instruments must relate to the three main approaches (or instrumental ways) of international rules for promoting integration. The first is to impose obligations on liberalization and access to markets. The second is to impose certain obligations of nondiscrimination on the legal framework applicable to transactions and operations covered by the agreements—basically most-favored-nation (MFN) status or national treatment (NT) obligations—while leaving domestic legislation intact. The third is to create uniform legislation establishing a common legal framework for transactions and operations covered by the agreement.

These three approaches differ legally and in terms of their political and economic implications. The obligations that accompany liberalization are strictly limited in scope to international transactions. Obligations as regards treatment (in particular if they apply to treatment of foreign firms and professionals after their establishment in the host country) as well as uniform or harmonized rules apply essentially to internal transactions (the only exception being that of the obligation to apply Most Favored Treatment in the access to the market). They are much more intrusive politically (and, as a consequence, much more difficult to tackle) than the former. But experience seems to prove that integration cannot rely solely on liberalization obligations in order to make sense in legal terms. Furthermore, it is becoming even clearer from a strictly economic perspective that market integration is not achieved by simply liberalizing access as long as internal rules continue to differ.

The two latter types of rules pose a difficult political dilemma. Uniform rules serve integration goals extremely well, but are very difficult to set up for at least three reasons. First, they are technically difficult to agree upon because of the different legal traditions and contexts of the parties, making it difficult to agree even on terminology and definitions. Second, they are intrusive in relation to the internal political process in so far as they are locked-in by international law, which precludes policy changes in internal regulation that may follow a switch of domestic governments and political majorities. And third, they threaten the adaptability of the regional scheme because they are more difficult to change than domestic rules since they require a consensus (or a qualified majority) among all parties.

Obligations regarding treatment drastically reduce these difficulties by allowing much greater discretionary power when it comes to domestic legislation, provided its content is nondiscriminatory. But such obligations also pose new difficulties. Uniform rules follow the same logic and have the same scope at the international and domestic levels. This is not the case with international obligations on treatment (in particular on treatment of enterprises). These obligations have a sort of double universality: they apply to all sectors and they cover all aspects of the legal framework applicable to enterprises.[4] On the domestic front, however, there is not a single rule or set of rules that has this double universality. Different rules apply to different sectors (energy or air transport, for example) and to different aspects of the legal framework (from company

[4] It is different when the obligation of treatment applies to goods: its scope is much narrower.

law to taxation, through labor conditions or expropriation, for example). With the sole exception of the European Community, experience shows that far-reaching obligations of treatment of enterprises can be accepted only if they are accompanied by a list of exceptions. But this list of exceptions tends to expand geometrically as the number of parties to the agreement increases. In the end, the list of exceptions overwhelms MFN and NT treatment.[5]

The two techniques for the enactment of the rules

Two different techniques enact regional rules and provide a framework for regional public activities. The traditional distinction between "intergovernmental" and "supranational" aims at defining them. But it has been used too loosely, in particular as a tool for comparing the European process (the incarnation of supranationality for many) with other processes. On the one hand, the European process has an extremely high degree of intergovernmentalism. To take just two examples, the elimination of tariffs within the zone was achieved essentially through an intergovernmental method, while the European Monetary System was, from beginning to end, an intergovernmental mechanism based on an agreement among Central Banks with absolutely no intervention from the European Community. On the other hand, supranationality is an important element for the World Trade Organization (WTO) and other international organizations (for example, when approving waivers or the entry of new Members into the organization, as we shall see at the end of this section).

Thus, it is better to replace that terminology with the more neutral of the two techniques that can be used by an integration treaty (as a matter of fact, by any international treaty) in order to enact rules. The techniques are to previously insert rules in the treaty that must be complied with by member states, and to institute some mechanism for creating laws within the framework of the agreement. We could refer to rules enacted by means of the first technique as "primary law" and to rules enacted by means of the second as "secondary law".

For example, the European Community—a legal entity with its own competency—provides the paradigm for using the second technique. However, the European process still relies just as much on the first one: the treaty itself contains a set of rules imposing far-reaching and serious obligations on member states when they exercise their own competencies, obligations which are underscored by the general overarching obligation of nondiscrimination as regards nationality in any area covered by the Treaty. NAFTA, by contrast, relies exclusively on the first technique. Many bilateral agreements of the European Community (alone or jointly with member states) with third countries also rely on the second technique: the creation of a joint institution able to produce additional law that deepens the content of the agreement.[6] There are advantages and

[5] This was one of the main reasons for the failure of the OECD's 1995-98 negotiations on a Multilateral Agreement on Investment (MAI).

[6] This supranational development, most often forgotten, proves that the distinction between intergovernmentalism and supranationalism has been much abused (and that the conclusion that supranationalism is difficult to conceive outside the European context is not well-founded). For example, the framework agreement between the European Community and its 15 member states and Mexico signed in 1997 was "filled up" later on by two decisions of the Joint Council and not by independent supplementary agreements. The choice of internal procedures followed by the different parties before their representatives in the Joint Council adopt the decisions depends on each party's constitutional

disadvantages to both techniques. The first tends to give strength and credibility to the risk of lack of flexibility and capacity for adaptation; the second tends to have the opposite effects.

The two techniques in order to define the scope of the obligations

WTO's GATS and ulterior negotiations on services and investment have made fashionable (at least between experts and practitioners) the jargon of "positive" and "negative" lists as techniques to define the scope of obligations in these areas. However, these techniques apply to any area covered by integration or, more generally, international economic rules.

It is possible to define general obligations subject to some exceptions. The rules apply "except if …". The exceptions can be of two types.

- The first is to exclude from the application of the rules some specific sectors, aspects or areas. This is the case, for example, with article II of GATS (MFN obligation) or with many obligations imposed by Bilateral Investment Treaties led by the United States.
- The second is not to exclude a priori any sector but to determine some circumstances in which Parties to the agreement are no longer obliged to apply the rules. This is the case, for example, with the set of exceptions established by GATT.

The "negative list" jargon refers to the first type of exceptions, but we should not forget that exceptions in the second sense can somehow be an alternative to the "negative" list.

On the other hand, it is also possible to define the content of the obligations but leave the determination of their field of application to a list of commitments (a "schedule of commitments"): the obligations apply "only insofar as …". For many, this approach, baptized as that of the "positive list", seems synonymous with GATS (that undoubtedly applies it, as we shall see). However, GATT's article II also applied it: its schedules of concessions are as "positive lists" as those of GATS.

Experts in the jargon argue very often that "negative" and "positive" lists can lead to the same results. The argument is as obvious as it is misleading:

- Of course, the content of a general obligation can be nearly nullified if the exceptions (the negative list) are very broad and deep in scope (or if a "horizontal" exception is included). And the content of an obligation whose scope is determined through a positive list can be very broad and deep if the list is very large.
- However, the underlying logic of the two techniques is very different. In the negative list approach, the underlying logic (and the practice in most relevant cases) establishes a horizon (to say the least) of full liberalization (in the case of a rule on market access) or of unrestricted nondiscriminatory treatment (in the case of a rule on treatment). In the positive list approach, the underlying logic is different: the idea is to define a "floor" of liberalization or nondiscrimination not

---

characteristics. In some cases they resemble those used in the approval of international agreements; in others they are completely different.

to be rolled back by changes in internal policies. Furthermore, if we consider the "double universality" (see above) of the notion of treatment to enterprises, we can argue that a list of specific exceptions simply means that we are brought to a "universality of a lower level", but universality at the end. Whereas a positive list of sectors will never reach any level of "universality".

An additional comment on Institutional Arrangements

Institutional arrangements (including dispute settlement and judicial control) are not in themselves instruments of integration. I would argue that they are, in any case, instruments of the instruments. The markets are successfully integrated to one degree or another by the rules liberalizing trade in goods or capital movement, for example, (or by rules harmonizing standards, in another example). Institutional arrangements help to increase or decrease the effectiveness of these rules and facilitate their adaptation, but, in themselves, do not integrate the markets.

A comparative examination proves that as long as the rules are effective, integration can proceed successfully (or risk failure) regardless of the institutional arrangements adopted in each process. NAFTA and the European process share some successes in spite of their completely different approaches to institutions. And Mercosur, which is institutionally light, shares some of the same failures as the institutionally heavy Andean Community.

This argument applies even to policies governing regional competition. It would seem that they cannot exist without the regional institutions or bodies to implement it. However, the example of the European Economic Area proves just the opposite. The European Economic Area Treaty includes provisions on competition policy, but their implementation is left to the institutions on both sides of the agreement: the preexisting ones on the European Community side and the new European Free Trade Area (EFTA) Surveillance Authority and EFTA Court on the EFTA side. Thus, here again, there is a clear-cut distinction between the instruments (common regional rules) and the institutional arrangements (left to each part) for implementation.

The existence or lack of a regional budget must also be discussed as a problem of institutional arrangements and not of proper instruments. Regional public activities can be implemented through regional or national budgets, or through a combination of both. Two examples from the European experience are illustrative. First, the Common Foreign and Security Policy (as it appeared in the Maastricht Treaty, not the present policy) provided two alternative forms of budgetary implementation: through the European Community budget and through national budgets. Second, the future of the Common Agricultural Policy depends partly on whether present implementation through the European Community budget is maintained or at least partially transferred and financed through national budgets. Each alternative has serious consequences on the strength and dynamism of the process.

An additional comment on Positive and Negative Integration

As it is well known, the distinction between "positive" and "negative" integration goes back at least to Tinbergen (1954). Pinder (1968) introduced it into the discussion of European Integration. Since, it has been widely used, for example by Nicolaodis, and

Scharpf (1997) gave a new push to it. However it is not completely clear what it does exactly mean.

In Tinbergen, “positive” integration seems to relate mainly to the existence of common rules, either through the conferral of competences to some supranational entity or through joint action, while “negative” integration would relate to non discrimination in national economic rules and policies under joint surveillance. But in Scharpf, the distinction relates much more to a politico-ideological approach to economic policies: “negative” integration would relate basically to an approach axed on liberalisation and deregulation while “positive” integration would be oriented to public intervention in the economy (certainly trough regional rules and policies). Pinder seems to lie somehow in between: joint or common rules would not be enough to define “positive” integration; some welfare purpose would also be needed.

The distinction remains useful (and I myself will use it below) in particular as a devise to broadly define alternative approaches to integration, one much more oriented to the elimination of market access restrictions and the other much more axed in establishing a more or less uniform regulation of a more or less unified market. However, the distinction seems to be difficult to apply to significant cases. Two examples are sufficient to argue this:

The European Community directives on the liberalization of movements of capitals seem to be a clear example of “negative” integration, but they were enacted according to what, in Tinbergen’s terms, would be a clear example of “positive integration” (and they would be defended in this way by many in the European Commission). In political terms, NAFTA’s Chapter XI on investments would be looked at by many around the world as a typical example of “negative integration” that sharply reduces the capacity of Governments to intervene in the economy. But nobody can deny that it is an excellent example of common rules that go much further than liberalization of access (for example on protection of investments); therefore, it could also be presented as an excellent example of “positive integration”.

I think that the analytical framework developed in the present paper can achieve the same results attainable through the distinction about “negative” and “positive” integration while being much sharper for other purposes.

The application of the distinctions to the GATT and to its evolution

On the basis of the three distinctions, GATT’s architecture becomes very transparent (in order to simplify, I’m referring to GATT 1994 together with the WTO agreement):

- As far as the types of rules is concerned, GATT uses only the first and the second:
    - Rules of access applicable to imports (article II in particular) and
    - Rules on treatment:
        - A general MFN rule applicable to imports (article I)
        - And a general NT rule (article III) applicable to internal legislation. But this internal legislation is not the object of the third type of rules (rules enacting uniform law).

- However, in the evolution of GATT since its inception, and in particular in the Tokyo and the Uruguay Rounds of negotiations, the need for some degree of uniform law has appeared and this explains the birth of some of the other Agreements of the Annex 1 A of the WTO Agreement, in particular those on Technical Barriers and Sanitary and Phitosanitary matters as well as those on Subsidies (and Agriculture as far as agricultural subsidies is concerned).

- As far as the technique for the enactment of the rules, GATT uses (maybe to the surprise of many, including experts) both the two techniques I have differentiated:
  - Indeed, GATT operates mainly through primary law, but
  - It also uses the second technique by instituting a mechanism able to produce secondary law that enters into force once approved by WTO organs without any act of ratification or transposition by Members. This mechanism applies to extremely important cases:
    - Approval of waivers (through a horizontal provision applicable to all WTO agreements: article IX.3 of the WTO agreement).
    - Entry of new Members and the definition of the set of rights and obligations arising from this entry (again, through a horizontal provision applicable to all WTO agreements: article XII of the WTO agreement).

- Concerning the technique for the definition of obligations,
  - GATT uses the second one ("positive lists") for the definition of its main obligation of binding/consolidation of a certain level of liberalization: the schedules of concessions that every Member annexes to the Agreement and that are, according to article II, integral part of the Agreement.
  - But, without introducing the technique of the "negative list", GATT is well endowed with a series of exceptions[7] that apply to all obligations.

If we compare GATT and GATS from this perspective, the difference becomes also very transparent:

- Concerning the second aspect (techniques for the enactment of rules), the situation is the same in both agreements because this is regulated in a horizontal manner by the WTO agreement.

- Concerning the first aspect (types of rules), GATS limits itself also to rules of access and of treatment. The need of some uniform law has also been noted, in particular in some sector (Reference Paper on Telecommunications), but the attempts to use this type of rules in the services sectors in GATS framework remain embryonic.

- Concerning the technique for the definition of obligations, great differences appear between GATS and GATT even if, as in the framework of GATT,

[7] GATT exceptions can be classified as: a) General political exceptions (arts. XX and XXI); b) Exceptions related to the "architecture" of the multilateral system (arts. XXIV and XXXVI; c) Exceptions justified by internal policy considerations (arts. XII and XIX); d) Antidumping and Countervailing duties (art. VI); e) Ad hoc exceptions –waivers- (art. IX WTO agreement).

market access liberalization is defined through a "positive list" of commitments[8].

- First, besides a set of exceptions similar to that of GATT, GATS introduces a "negative list" approach in order to define the scope of the general MFN obligation established by its article II.
- Second, the NT obligation is not applicable in general as that of Article III GATT but applies only insofar the sector and aspect concerned is included in a "positive list"[9]

[8] However, once a sector or subsector is included in the list of commitments, the "negative list" technique applies: access tot the sector is liberalized except for those aspects especifically listed.
[9] The technique explained in the preceding footnote concerning access applies also to the definition of the scope of the NT obligation.

III.- The use of the toolbox in different areas of Regional Integration: a comparative examination on the basis of European Integration[10]

After the GATT and GATS example, we can examine how the toolbox is used in the main areas of integration by the European Community Treaty and other Treaties.

1.- Intrazone trade in goods:

- In this area, the EC Treaty uses, first, horizontal rules liberalizing (arts. 25, 28 and 29) and imposing the obligation of National Treatment (general obligation of article 12 and other specific articles, like art. 90 on internal indirect taxation), enacted trough the first technique (primary law) and using the first technique for the definition of obligations (with no negative list but with an important list of exceptions –art. 30 in particular-). In this respect, NAFTA and Mercosur are quite similar (even if MERCOSUR does not addresses restrictions on exports and concentrates much more than the other two processes on duties as concerns imports). This is the approach that very often is qualified like "authomatic liberalization".
- The deep difference among the three processes relates to the use of rules of uniform law (or harmonization). The scope of the sophisticated mechanism of production of secondary law instituted by the TEC (in particular arts. 95 and 94) extends to this question. NAFTA does not create such a mechanism (and, as a consequence, abandons any attempt to harmonise internal legislation applicable to production and trade of goods). MERCOSUR envisages the production of secondary law but the mechanism it institutes is extremely faulty and has not worked well.
- The jurisprudence of the European Court of Justice ("Cassis de Dijon" case-law[11]) has somehow confused the areas tackled by the rules of access and by harmonization of internal legislation in so far as it has qualified as "measures equivalent to quantitative restrictions" nondiscriminatory internal legislation that, in its application to goods produced in other member states, would impede their sale in the member state that imported them. However, in spite of this confusion, the difference between those two areas remains because of two reasons: a) because the scope of application of that jurisprudence is limited (and much more limited after the Keck sentence[12] reduced it further), and b) because a great deal of this measures are justified by the set of exceptions of article 30 (former article 36) and, as a result, the "indirect barriers" remain except if they are removed by harmonization, that is by the enactment of uniform rules through secondary law.

2.- Extra zone trade in goods: the construction of a Customs Union.

This area is not covered by NAFTA, a treaty that has no "external dimension".

[10] The analysis is limited to trade in goods, exchanges of services and "investments" (i.e. movements of capitals and right of establishment). It can be easily extended to the remaining areas, movement of workers in particular.
[11] Case C – 120/78, E.C.R. 1979,p. 649
[12] Joined Cases 267/91 and 268/91, Criminal Proceedings against Bernard Keck and David Mithouard, 1993 E.C.R. I - 6097

The TEC tackles this area as follows:

- First, by a rule of access: that defining a common customs tariff. Initially, it was defined through primary law (by means of a mechanism of authomatic convergence of duties[13]). Once defined, its modification was and is left to secondary law (art. 26). The common regime allowed for member states specificities, that were only eliminated after 1992, and even then with transitory periods that lasted until the XXI th century (and, even now, there is no common regime for arms). The existence of these specificities required a derogation to the primary law principle of free circulation of imports –see just below- (because without this derogation the specificity would have been easily circumvented by means of imports trough another member State); this derogation was subject to a procedure and required the production of some secondary law (art. 134). MERCOSUR relied only on the second technique of enactment of rules, that, as in all other areas covered by this second technique, has not worked satisfactory.
- But the TEC included also a rule of access enacted as primary law, i.e. introduced in the Treaty itself: the rule of free circulation of imports after their legal entry into the common customs territory by whatever point (art. 23.2). This is the rule that is completely missing in the Latin American integration processes. In the absence of it, these processes are not "incomplete Customs Unions" but simply Free Trade Zones with a more or less harmonized external tariff (they are not "incomplete Customs Unions" because they are never a single customs territory, not even when the duties they apply to imports from third countries are the same: the duties must be paid again when these imports circulate among members states after the first importation).
- The enactment of the rule of free circulation through primary law created the need for the construction of a unified customs territory. This required a great deal of secondary law not only on procedures related to access but also in some aspects of internal legislation: the end result, the "EC Customs code"[14] is the longest and more complex piece of secondary Community law.

3.- Intrazone exchanges of services

Mutatis mutandis, the TEC addresses intrazone imports and exports of services much in the same way as trade in goods (art. 49). However, as the "direct barriers" to imports of services are much less numerous and sophisticated than those existing in trade in goods, the problem of the "indirect barriers" to trade in services resulting from the divergences in internal legislation (even if it is nondiscriminatory) appears greater. This problem has been tackled in the same way as in the area of trade in goods: by means of the

[13] The simplification introduced in the ECT by the Treaty of Amsterdam deleted from it the provisions relating to the transitional period leading to full liberalization of intrazone trade in goods. The equivalent to these provisions is to be found now in the Treaties of Accession of new Members.

[14] Council Regulation (EEC) No 2913/92 of 12 October 1992, developed by Commission Regulation (EEC) No 2454/93 of 2 July 1993 laying down provisions for the implementation of Council Regulation (EEC) No 2913/92 establishing the Community Customs Code [Official Journal L 253 of 11.10.1993]. The Commission presented in November 2005 a proposal for a new Customs Code that is still under discussion in the Council and the Parliament.

production of uniform rules through secondary law (arts. 52 and 55). An equivalent of the "Cassis de Dijon" jurisprudence has somehow reduced the need for this task of harmonization without however eliminating it (for the same reasons). As a matter of fact, it has been the amount of harmonization still needed in order to suppress the "indirect barriers" still remaining that has prompted the European Commission to propose to the Council and the Parliament the so-called "Bolkenstein directive"[15]. This proposal, under the cover of "harmonization", aimed really at producing, by means of secondary law, a rule that was not included in the TEC as primary law: that services can circulate between member states provided that they comply with the applicable rules in the country of origin and without having to comply with the rules of the country of destination. The directive has been finally approved with a lot of exceptions and it is too early to judge its actual practical content and effects.

NAFTA is not so different from the EC Treaty as far as the inclusion in its primary law of rules of liberalization of access and National Treatment on intrazone exchanges of services (Chapter XII). However, it limits the scope of the obligations not only by means of exceptions but also by means of a negative list of excluded sectors (arts. 1206 and 1207). The great difference between NAFTA and the TEC lies, as always, in the fact that NAFTA is completely static in the sense of not instituting any mechanism of production of secondary law and, as a result, abandoning any attempt to harmonise internal legislation.

MERCOSUR did not have in the Asunción Treaty any rule of primary law concerning exchanges of services. In principle, this had to be left to secondary law. In actual fact, there has been no secondary law but simply an addition to primary law: the Montevideo Protocol on services, copied from the GATS with only minor exceptions (and, as GATS itself, including foreign direct investment in services sectors, baptized as "commercial presence").

4.- Extrazone exchanges of services

Neither the TEC nor NAFTA and MERCOSUR covered this area by means of primary law. It remained, in principle, outside the scope of Regional Integration. However, the TEC (and only it) envisaged the possibility of extending to it the scope of secondary law: a) directly (art. 49.2, never applied) and b) as an aspect of internal measures adopted on the basis of arts. 52 and 55). Yet, even this second possibility has been applied in a a very limited manner and the legal regime applicable to imports and exports of services from and to third countries remains an area covered essentially by member states legislation and outside the scope of Community law.

The first significant change to this situation came from ECJ jurisprudence, in its 1/94 Opinion[16] (of compulsory application) on the distribution of competences between the European Community and member states concerning the WTO agreements. The Court,

[15] European Parliament and Council Directive 2006/123 of 12th of December 2006, OJ L 376, p. 36.

[16] Opinion of the Court of 15 November 1994 on the Competence of the Community to conclude international agreements concerning services and the protection of intellectual property - Article 228 (6) of the EC Treaty. 1994 E.C.R. 1994 p. I-05267

while recognizing member states competence in the area of extrazone exchanges of services, judged that mode 1 of GATS (cross-border supply) was covered by the external exclusive competence of the European Community. However, this ECJ's decision has remained with no practical effect because the European Community has proved unable to legislate on this area, that continues to be covered, not only internally but externally (international agreements), by individual Member States.

The second significant change comes from the modifications introduced by the Treaty of Nice on the EC Treaty. In the new text of article 133 (Commercial Policy), the Treaty of Nice imported GATS notion of "trade in services" and extended to it the competence conferred to the European Community by that article. However, the meaning of this is not yet clear in the absence of specific jurisprudence by the ECJ.

5.- Investments (Movements of capital and right of establishment)

"Investments" is a very tricky concept. As a matter of fact, the legal questions likely to arise with respect to investment from third countries occur in three areas which it is important to differentiate (I'll concentrate in the first two):

- capital movements;
- conditions of establishment in the various economic sectors;
- the arrangements applicable after establishment.

Capital movements from another country and the establishment of another country nationals or companies in a given State are two completely different matters, although there is a link between them.

- Capital movements from other countries are transactions or transfers involving monetary or financial assets between those countries and a given State; they are not necessarily connected with establishment in a different country from the one in which the capital in question originated;
- the establishment in a given State of a national or company from another country presupposes the formation of a subsidiary undertaking, branch or agency [17], or the total or partial acquisition of an existing entity; the capital needed for such formation or acquisition need not come from the third country of the national or company in question or even from another third country: it may be obtained on the national financial market of the Member State in which the establishment takes place.

The EEC Treaty devoted separate Chapters (in Title III of Part Three) to the question of the movement of capital (Chapter 4 "Capital and payments") on the one hand and of the conditions of establishment (Chapter 2 "Right of establishment") on the other. The Treaty on European Union did not change that distinction although it amended Chapter 4 of the TEC on "Capital and Payments" by substituting Articles 73b to 73g, present Articles 56 to 60, for Articles 67 to 73.

As regards investment from third countries, there is an essential difference between Chapter 4 (movement of capital) and Chapter 2 (right of establishment) of the EC

(17) For the purposes of this paper there is no need to expand on the definitions of "subsidiary undertaking", "branch" or "agency" nor to consider whether other forms of establishment exist.

Treaty: Chapter 4 covers not only the movement of capital between Member States but also the movement of capital from third countries; Chapter 2 for its part covers, in principle [18], only the problem of the establishment in the Member States of nationals and companies from the other Member States.

NAFTA, on the contrary, covers both aspects (movements of capital and right of establishment) in the same chapter (chapter XI). As always in NAFTA's framework, only the first technique for the enactment of rules is used (primary law). The three types of rules are used: not only rules of access and rules on National Treatment but also uniform law, in particular for a topic as sensitive as that of investment protection. Finally, concerning the definition of the scope of obligations, a negative list technique is used.

In MERCOSUR, the Protocole of Colonia follows NAFTA approach. However it has not yet entered into force and in all probability will never do.

Movements of capital (intra- and extrazone) in the EC Treaty

Even before Maastricht, Articles 70 and 72 of Chapter 4 of Title III of Part Three of the EEC Treaty already referred to movements of capital between Member States and third countries and imposed certain obligations on Member States while giving the Community certain powers. These powers were initially implemented in a limited way by Council Directive 72/156/EEC of 21 March 1972 on regulating international capital flows [19] and subsequently, more comprehensively, by Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty. [20]

Articles 73b to 73g, present Articles 56 to 60, introduced into the TEC by the Treaty on European Union, replaced former Articles 67 to 73 and extended the scope not only of the obligations imposed on Member States but also of the Community's powers with respect to the movement of capital from third countries. The purpose of this paper is not to analyse in detail each of the provisions of Chapters 4 (movements of capital) and 2 (right of establishment) of Title III of Part Three of the Treaty. It will be sufficient to indicate, with respect to the general arrangements applicable to movements of capital from or to third countries as provided for in Articles 56 to 60, former Articles 73b to 73g:

- that the Member States' powers must be exercised within the limits of the obligations imposed on them by Articles 56, 57 (1) and 58;

- that the Community has potential competence as regards all the arrangements applying to capital movements (Article 57(2), first sentence) and has exclusive competence to adopt the measures provided for in Article 57(2), second sentence, and in Article 59;

- that paragraphs 1 and 2 of Article 60 establish ad hoc arrangements for the particular case referred to in that Article.

---

(18) See below.

(19) Council Directive 72/156/EEC of 21 March 1972 on regulating international capital flows and neutralizing their undesirable effects on domestic liquidity (OJ No L 91, 18.4.1972, p. 13). That Directive was repealed by Directive 88/361/EEC referred to below.

(20) OJ No L 178, 8.7.1988, p. 5.

Present articles 56 to 60 are essentially rules of access enacted in primary law. No negative list of exceptions is envisaged for intrazone movements while a carve out of measures already existing in 1992 is established for extrazone movements; and the circumstances in which some exceptions are applicable are defined very restrictively for intrazone movements while there is much room for them in extrazone movements . Finally, the scope for the production of secondary legislation is very narrow concerning intrazone movements while being broader for extrazone movements.

Consequently, "automatic liberalization" in intrazone movements of capital is even deeper and with less exceptions than that in the area of trade in goods (and partially extends also to extrazone movements). This is very significant in an economic policy perspective, as we shall see in the next section

Establishment in the EC Treaty

While the chapter on movements of capitals applies both to intra and to extrazone, the ECT Chapter on Right of Establishment "contain(s) no provision on the problem of the first establishment of nationals of non-member countries" [(21)]. Nonetheless, "although the only objective expressly mentioned in the chapter(s) on the right of establishment ..... is the attainment of [that] freedom(s) for nationals of Member States of the Community, it does not follow that the Community institutions are prohibited from using the powers conferred on them in that field in order to specify the treatment which is to be accorded to nationals of non-member countries." [(22)] I.e. secondary law can apply to the right of establishment of third-country companies and nationals. Indeed, the Community legislator has introduced provisions on into a number of acts based on Articles in the right-of-establishment Chapter which apply either to a specific economic sector or to a specific aspect of undertakings' activities, such as for instance [(23)]:

- the second banking Directive [(24)] ;
- the Directive on investment services in the securities field; [(25)]
- the insurance/assurance Directives [(26)];
- the Directive on disclosure requirements in respect of certain branches [(27)].

In order to understand how the ECT chapter on right of establishment uses the toolbox, it has to be noted that the right of establishment has a logic very different from that of

(21) Court of Justice Opinion 1/94 of 15 November 1994, already cited, paragraph 81, [ECR] p. I-5412.
(22) Ibid, paragraph 90, p. I-5415.
(23) The only examples given here are those analysed by the Court of Justice in the aforesaid Opinion 1/94.
(24) Second Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC (OJ No L 386, 30.12.1989, p.1).
(25) Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (OJ No L 141, 11.6.1993, p. 27).
(26) Council Directive 90/618/EEC of 8 November 1990 amending, particularly as regards motor vehicle liability insurance, Directive 73/239/EEC and Directive 88/357/EEC which concern the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance (OJ No L 330, 29.11.1990, p. 44); second Council Directive 90/619/EEC of 8 November 1990 on the coordination of laws, regulations and administrative provisions relating to direct life assurance, laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 79/267/EEC (OJ No L 330, 29.11.1990, p. 50).
(27) Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another Member State (OJ No L 395, 30.12.1989, p. 36).

the freedom of movements of goods, services and capitals. Indeed, the exercise of the right of establishment is somehow previous to putting into the market the goods, the services and even the capitals (or, at least, the financial assets for which will be exchanged the monetary assets) that will then circulate within or between member states. Access to its own country market of goods, services, capitals and workers can be more or less restricted (because of age, for example, for workers) but no legal act of entry into the market is required. Contrariwise, this is exactly the meaning of "establishment": nationals must "establish" themselves (as a firm, or as a professional) within their own markets. Looked at from the perspective of other member states or form third countries, establishment is also previous to the production of goods, provision of services or creation of financial assets in the host country. It would be perfectly possible, for example, that establishment from another member state or from a third country be authorized but some specific activity be not.

Therefore, as far as right of establishment is concerned, the essential distinction is that existing between unregulated right of establishment (as a matter of fact, little regulated - as in the opening of a toys shop-, because there are always requirements to be fulfilled before establishing as a professional or creating a firm) and regulated/highly regulated right of establishment. When right of establishment is regulated (and, in principle it is always more or less regulated), the problems that appear, from the perspective of EC law, are two:

- that of the possible discrimination of professionals and firms from other member states, and
- that of the divergences among national legislations and the "indirect barriers" to establishment from other member states that they would create.

As a result, the main logic of the right of establishment chapter of the EC Treaty is not that of the liberalisation of access but

- that of the National Treatment obligation (art. 43.1 and 43.2), as far as primary law is concerned (interpreted very strongly and extensively by the European Court of Justice)
- that of the production of uniform norms by means of secondary law (arts. 44 and 47) in order to progressively develop an integrated economic area or market.

In other terms, we are in the antipodes of the "authomatic liberalization" approach that applies to trade in goods or services and to movement of capitals.

IV.- THE LEGAL, ECONOMIC AND POLITICAL SIGNIFICANCE OF THE CHOICE OF THE TOOLS: THE "*GOLDEN SHARE*" CASE-LAW OF THE EUROPEAN COURT OF JUSTICE[28]

During the 1990s, many member states introduced "golden share" provisions in different pieces of their national legislation, in particular those privatizing public companies. By means of these provisions, Governments reserved to themselves some veto power on specific future operations of those companies (or relating to them). Most of these pieces of legislation were very poorly drafted (and copied each other) because they did not refer to a general power of surveillance on the company's economic activities that would become operational in some defined circumstances but focused exclusively operations leading to their control or to the acquisition of some of their assets.

The European Commission introduced a series of proceeding before the European Court of Justice attacking those pieces of legislation by violation of the provisions of the EC Treaty chapter on movement of capitals [29], i.e. rules of access of primary law. Member States accepted this approach and the Court ruled in favour of the Commission (with the exception of the case concerning a Belgian norm, for which the Court managed to improvise an exception with no basis in any provision of the Treaty).

It seems pretty obvious to anyone that the approach put forward by the Commission, accepted by Member States and followed by the Court is, to say the least, open to discussion. Everyone knows the distinction between macroeconomic policy and sectorial policies, and it is agreed economic and political common sense that the regulation of international capital movements relates to the former and not the latter. Contrariwise, golden share provisions have nothing to do with the amount or type of foreign capital to enter or to leave a given country nor with the typical issues of "macroeconomic equilibrium" in the framework of which the liberalization of capital movements is discussed; they relate to specific policies (and specific regulation) in specific sectors. If this agreed common sense had been applied to the golden share Court cases, the relevant chapter would not have been that on movement of capitals but on right of establishment.

But, as we have seen, the approach followed by the chapter on right of establishment is completely different from that of the chapter on movement of capitals on two of our three distinctions:

- its focus is on National Treatment and uniform law (harmonisation of the conditions of establishment) instead of being on liberalization of access (of capitals) and
- the technique it favours is that of the progressive development of secondary law instead of that of the direct application of prohibitions imposed by primary law.

[28] This section simply summarizes Torrent, 2007, where the interested reader will find the argument developed in depth.

[29] The Comission attacked them also in the framework of the chapter on right of establishment, but this was a subsidiary argument that was not even considered by the Court.

Placed in the context of the chapter of right of establishment, the golden share provisions look completely different. They have to be analyzed under the National Treatment standard[30]. If they comply with it, the divergences among national norms (and the indirect barriers undoubtedly arising from them) can only be tackled trough harmonisation by means of secondary law.

The argument can certainly by put in terms of the more usual distinction about "negative" and "positive" integration: in a matter so essential for European integration as the legal regime of foreign investment among member states, the European Commission and the European Court have willingly chosen the path of "negative integration" by playing the game within the chapter of movement of capitals instead of playing it within that on right of establishment. But in order to understand why this argument is true we must rely on the distinctions discussed in this paper: the argument is true because the types of rules and the techniques used for their enactment are different in each chapter.

Conclusions

1.- The distinctions between the three types of rules, the two techniques that can be used for their enactment and the two techniques applicable to the definition of the scope of obligations are useful, as an analytical device, in order to reveal not only the legal architecture but also the inner political logic of integration processes in the different areas they cover.

2.- If this is so, the work initiated with this paper could give rise to a research project that would deepen and refine the analysis in order to allow for a systematic comparative examination of bilateral, regional and multilateral agreements as well as in order to develop new approaches to international rule making in the areas covered by these agreements.

[30] And many of the pieces of legislation could have been considered as not complying with this standard.

Bibliography

Balassa, B. (1961) *The Theory of Economic Integration*. Irwin: Homewood, Illinois

Bouzas, R, Motta Veiga, P, Torrent, R (2003) *In-depth Analysis of Mercosur Integration, its Prospectives and the Effects thereof on the Market Sccess of EU Goods, Services and Investments.* http://mkaccdb.eu.int/study/studies/32.doc

Devlin, R and Estevadeordal, A (2003) *Bridges for Development. Policies and Institutions for Trade and Integration*, IADB, Washington D.C., 2003

Pinder J. (1968) "Positive Integration and Negative Integration: Some Problems of Economic Union in the EEC", *World Today* 24/3

Scharpf, F. (1997) "Balancing Positive and Negative Integration: The Regulatory Options for Europe", *MPIfG Working Paper 97/8,* November 1997

Tinbergen, J. (1951) *International Economic Co-operation,* Amsterdam and Bruxelles, Elsevier; London, Cleaver Hume Press, 1954

Torrent, R. (2003) "Regional Integration Instruments and Dimensions: An Analytical Framework", in Devlin, Estevadeordal (2003)

Torrent, R. (2006) "Una aproximación a la anatomía del Mercosur real", in Berlinski, J, Pires de Sousa, F y Chudnovsky, A y López A. eds., 15 años de MERCOSUR**:** Comercio, Macroeconomía e Inversiones Extranjeras, Red Mercosur de Investigaciones Económicas, Montevideo 2006.

Torrent, R (2007) "Derecho comunitario e Inversiones extranjeras directas: Libre circulación de los capitals vs. Regulación no discriminatoria del establecimiento. De la *Golden Share* a los nuevos *Open Skies*", en *Revista española de Derecho Europeo,* n.22, Abril-Junio 2007.