HARMONISATION AND THE EU INTERNAL MARKET

A Law and Economics Approach

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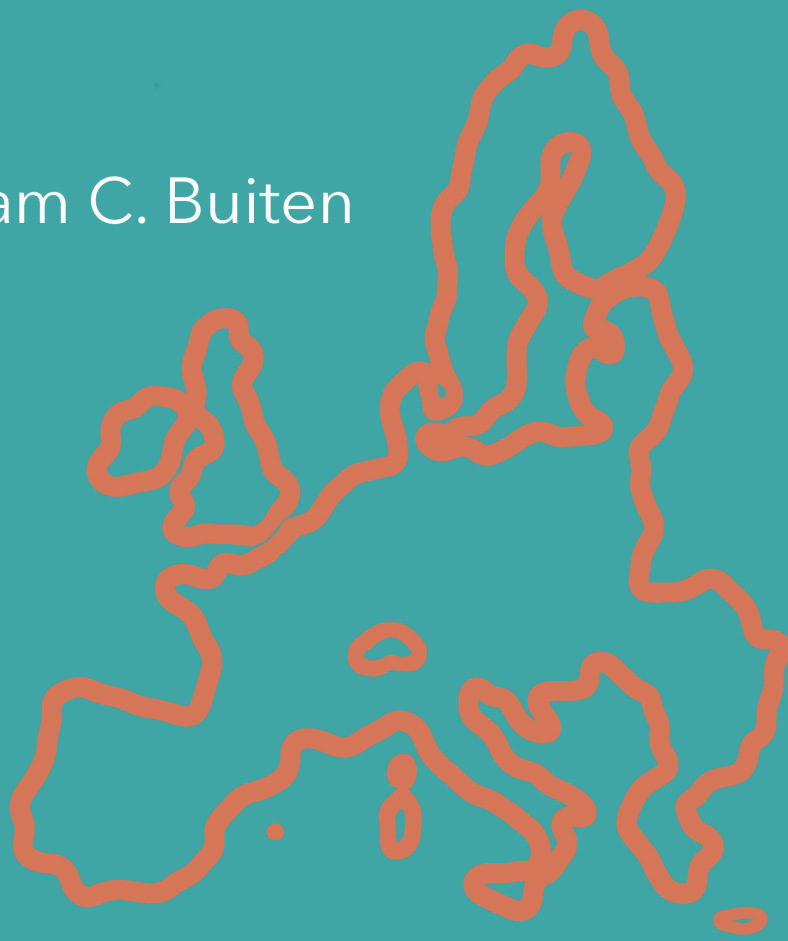

HARMONISATION AND THE EU INTERNAL MARKET: A LAW AND ECONOMICS APPROACH

MIRIAM C. BUITEN

Harmonisation and the EU Internal Market:

A Law and Economics approach

Harmonisatie en de Europese interne markt:

Een rechtseconomische analyse

Proefschrift ter verkrijging van de graad van doctor aan de
Erasmus Universiteit Rotterdam op gezag van
de rector magnificus
Prof.dr. H.A.P. Pols
en volgens besluit van het College voor Promoties

De openbare verdediging zal plaatsvinden op
donderdag 8 juni 2017 om 13.30 uur
door

Miriam Caroline Buiten
geboren te Nijmegen, Nederland

Erasmus University Rotterdam

Promotiecommissie

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This thesis was written as part of the European Doctorate in Law and Economics programme

An international collaboration between the Universities of Bologna, Hamburg and Rotterdam.
As part of this programme, the thesis has been submitted to the Universities of Bologna, Hamburg and Rotterdam to obtain a doctoral degree.

To my father

Acknowledgement

Having reached the end of this PhD, I am grateful to have had this opportunity to learn, develop myself and meet many wonderful people. While a PhD is often described as a solitary journey, I had the good fortune of sharing this experience with a great group of EDLE colleagues. I wish to thank them wholeheartedly for their support and their friendship, and our good times having aperitivos at Le Stanze in Bologna, barbecues at the Alster lake in Hamburg and beers at De Smitse in Rotterdam.

I am very grateful to my supervisors Neil Rickman and Roger Van den Bergh for their continuous support. I will not forget when Neil flew in just to meet with me, and we spent the day at Schiphol Airport working on one of the models. When I visited Neil in Surrey, he kindly invited me into his home so that I would not miss the World Football Championship. I will also remember singing the Erasmus Mundus song with Roger during the Rotterdam Midterm meeting, as well as our meetings where we discussed, besides the direction of my research, many policy issues that simply interested us.

I benefited greatly from the discussions with colleagues in Bologna, Hamburg and Rotterdam, and I thank the administrative staff for their support. I am thankful to all colleagues at RILE. I should especially mention Louis Visscher, who hired me as a student-assistant at RILE in 2011, and certainly shares some of the blame for me becoming a Law and Economics researcher. I treasure his support throughout my studies, and will miss our ESL band rehearsals and performances. I also owe a great deal of thanks to Klaus Heine, whose kind support for me and my research means a lot to me. I am also grateful to my colleagues at Stibbe, who reminded me of the reality behind my theories.

I express my deep gratitude to my friends and family, for their interest and support, and especially to my mother and brother, who always had a listening ear. Writing the dissertation was a challenging, but enriching and rewarding experience. Most importantly, it is in this PhD program that I met Max. I could not have finished this research without his support, and I feel grateful for the joy he brings to my life.

Finally, I thank my father, who always encouraged me and inspired me. I dedicate this book to him.

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Chapter 1

Introduction

This thesis investigates the legal and economic considerations to be taken into account when determining whether it is necessary and desirable to harmonise aspects of private law for improving the functioning of the internal market. In this introduction, the motivation for studying this topic is explained and the topic is placed in its societal context. This introduction also presents the aims of this research, as well as the research question and methodology used in this thesis. It provides the framework within which the research of this thesis has to be read. To that end, an overview is presented of the contents of the thesis.

1.1 Motivation

1.1.1 Where should integration lead?

During the last years, the European Union has faced the questions of its legitimacy, its role and its future more fiercely than ever since the European project was initiated. It is clear from the rise of Euroskeptic political parties in various EU countries and, most clearly, the 'Brexit' vote in June 2016, that at least some citizens in the European Union feel that EU law regulates too many aspects of

their lives. For example, proposals to regulate the energy use of vacuum cleaners, the minimum sugar percentage in jam and the requirements for water-saving shower heads were met with popular criticism.[1] People accused Brussels of imposing unnecessary red tape, and of unwarranted meddling that increases costs of firms. While in some cases the media coverage of these European policies grossly exaggerated the actual obligations under the EU laws, or failed to accurately convey their rationales, the sentiment is nevertheless one of growing Euroscepticism.[2] The need for reform also reached the European institutions themselves, with Commissioner Mc Creevy stating in 2007 that '[we] need to improve the ownership in the Member States'.[3] As the 'Brexit' vote loomed, European Commission President Jean-Claude Juncker conceded that the European Union is interfering in too many domains of people's private lives, and in too many domains where the Member States are better placed to take action and pass legislation.[4]

Scepticism and disagreement regarding European integration is not new, but rather a recurring, and perhaps even continuous aspect of the EU project.[5] For example, the Dutch and French rejections of the European constitution in 2005 also demonstrated a wish of groups of people to put a stop to further European integration. Nevertheless, the vote of Great-Britain in June 2016 to leave the European Union marks a turning point. An ever-growing and ever-deepening Union is apparently no longer a given fact.

[1] See regarding the rules on vacuum cleaners e.g. Daily Mail, 'Power surge! Fourfold rise in sales of super vacuums: Some customers buying two or more models to beat new EU regulations', 1 September 2014. Available at `http://www.dailymail.co.uk`.

[2] The Guardian article 'The super vacuum ban isn't meddling EU bureaucracy - it's absolutely vital', 2 September 2014, criticises news coverage such as that in the Daily Mail mentioned above for completely neglecting the policy rationale of the vacuum cleaner rules, namely to induce producers to design energy-efficient appliances.

[3] C McCreevy, 'The Future of the Single Market' (Sofia University, Sofia, 14 May 2007). Available at `http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/308&format=HTML&aged=1&language=EN&guiLanguage=en>`, accessed on 2.2.2016.

[4] Parliamentary Address of the Council of Europe, April 19 2016, answering a question asked by British lawmaker Nigel Evans on his plans to curb the growing Euroscepticism. See e.g. `http://uk.reuters.com/article/uk-britain-eu-juncker-idUKKCN0XG2NF`.

[5] According to Medrano (2012, 199), the erosion of public support for the EU can be seen as both the cause and the consequence of the rocky road toward further European integration.

One of the main challenges of the EU today, if not the primary challenge, is to convince citizens of the benefits that EU law and policy offers them, and the problems it can help to solve. The future of Europe depends on its citizens seeing the European project as empowering them, rather than only imposing costs or burdensome rules on them (Wyatt, 2003). Such a future depends on citizens' sense of ownership of the European project, in which both the EU legislator and Member States' governments play a role.

Besides the need to convey the benefits of the EU to citizens, the EU-critique also emphasises the need to address the question of the limits of harmonisation of policies on the EU level. A key question for further EU integration is which matters should be addressed by the EU rather than by the Member States, and what is the ultimate goal of European integration.

1.1.2 Expansion of EU powers and the internal market

The question of what the EU should do and where integration should lead to is particularly relevant against the background of an ever-expanding range of policy areas affected by European policy during the last decades.[6] At the outset of European cooperation, the EU focused upon economic integration and establishing a common market, by ensuring the four freedoms: the free movement of goods, persons, capital and services.[7] The idea was that as the Member States' economies became more intertwined, the interests in maintaining peace would be increased. The 1957 Treaty of Rome states this political aim of 'an ever-closer union among the peoples of Europe' that 'pool their resources to preserve and strengthen peace and liberty', as well as the economic means to achieve it, namely 'by means of a common commercial policy, to the progressive abolition of restrictions on international trade'.[8] The immediate goal of establishing a common market primarily

[6] See on the growth of the EU powers e.g. Estella (2002, 9-36).

[7] The four freedoms, comprising of the free movement of goods, services, capital and persons within the EU, were introduced with the Rome Treaty and form the basis for the internal market of the EU. See further chapter 3 below.

[8] Treaty Establishing the European Economic Community, 25 March 1957, 298 U.N.T.S. 11 (hereinafter Treaty of Rome), Preamble. See further Barnard and Peers (2014).

involved eliminating barriers that restricted the four freedoms, what Tinbergen (1954) called negative integration.[9]

Over time, however, the goal of establishing the internal market started to require the creation of harmonised rules as well. This positive integration initially concerned policy areas that connected closely to the internal market, such as product requirements. Increasingly, the internal market's legal basis opened up the possibility for harmonisation in a wide range of policy areas, that many may not have foreseen when thinking of establishing an internal market.

1.1.3 Harmonisation of private law

An example of an area of law that may not have been thought of as an internal market project is private law. The legislative competence to harmonise rules for the improvement of the internal market, laid down in Article 114 of the Treaty on the Functioning of the European Union (TFEU), underpins a number of EU measures that concern matters of private law. It forms the basis for consumer contract law policies, such as the Consumer Rights Directive (2011) and the recent proposals for Digital Contract Directives (2015), which lay down fixed European rules for consumer contracts. The internal market's legal basis also underlies the harmonisation of rules for antitrust damages claims. The Antitrust Damages Directive (2014) stipulates common minimum rules regarding private damages claims in antitrust cases, with the aim of improving the functioning of the internal market. In each of these cases, aspects of private law have been harmonised on the basis of improving the functioning of the internal market.

Harmonisation of private law might go beyond what Member States' leaders initially had in mind in relation to the goal of building a European internal market. Indeed, while the EU has been successful in harmonising national laws in many policy areas, it has failed to obtain full support for its ambition to harmonise private law in its entirety.[10] A first explanation for this resistance of Member States

[9] See further chapter 3 below.

[10] On the critical responses of Member States, particularly France and the United Kingdom,

to harmonise the laws governing private relationships may be that private law is part of national culture. A second, historical reason may be that in most European countries, codification of private law coincided with the rise of the nation state in the nineteenth century. This link between the nation state and having a civil code may explain why harmonisation of private law is objected to, because it is seen as part of the national traditions of Member States.[11] A comprehensive harmonisation of private law may therefore be viewed as too closely linked to Member States' national identity for it to be adaptable to a European model.

Nevertheless, in policies like the ones mentioned above we observe a 'piecemeal' harmonisation of private law, pushed forward under the umbrella of the internal market. These EU measures generally focus on the goal of reducing the variation in Member States' rules, which, in itself, is considered to be an obstacle to the internal market. An example of the argument that legal differences form a barrier to the internal market that needs to be removed can be found in the Impact Assessment to the Proposed Digital Contracts Directives (2015), which states the following:[12]

> 'different national mandatory rules [...] create costs and complexity for businesses and negatively affect the volume of cross-border trade as well as consumer welfare.
>
> [...] Member States on their own initiative would not be able to remove the barriers that exist between national legislations. Each Member State individually would not be able to ensure the overall coherence of its legislation with other Member States' legislations. This is why an initiative at the EU level is necessary.'

When legal differences are considered to be an obstacle to the internal market,

to growing European integration in the field of private law, see e.g. Sefton-Green (2012).

[11] See the summary of the research project 'Harmonising private law in Europe: a mission impossible?' led by Professor Jan Smits and Professor Martijn Hesselink, 2008-2012. Available at `http://www.hiil.org/project/harmonising-private-law-in-europe-a-mission-impossible`.

[12] Impact Assessment accompanying the Proposals for Directives of the European Parliament and of the Council on (1) certain aspects concerning contracts for the supply of digital content and (2) on certain aspects concerning contracts for the online and other distance sales of goods, SWD/2015/0274 final/2 - 2914/0287 (COD), p. 21.

the logical conclusion is that European intervention is necessary. In the scholarly literature this wide use of the legal basis for the internal market has been met with criticism. Several commentators have questioned whether the internal market's legal basis has been stretched too far, and if, considering its current use, it knows any limits (Weatherill, 2004a; Rühl, 2015).[13] While Article 114 TFEU is functionally broad, delimited only in its objective of improving the internal market and not in terms of subject matter, it only legitimises taking measures to overcome existing obstacles to the internal market.[14] It does not allow for the harmonisation or unification of civil law as such (Hess, 2010, 51-55). However, it is difficult to see how there could be room for arguments against European harmonisation if differences between Member States' rules are equated with an obstacle to the internal market that needs to be removed. If the goal of EU policy is to reduce variation in rules, this goal itself answers the question of the need for European intervention.

In light of the societal critique on European interference in general, and Member States' reluctance to harmonise private law in particular, such a 'short cut' to harmonising aspects of private law may be seen as problematic. The limited focus on eliminating legal differences by considering them as internal market barriers to justify new European policy may be one cause of harmonisation going beyond what Member States and citizens find necessary and acceptable. This raises the question of whether the current EU approach to policy making in the area of private law increases welfare. It also raises the questions of whether a more cautious approach should be taken to harmonising private law to improve the internal market, and what such an approach should look like.

[13] See further chapter 3.

[14] In terms of subject matter, Article 114(2) TFEU only excludes harmonisation of fiscal provisions, those relating to free movement of persons, and those relating to the rights and interests of employed persons. See further chapter 3.

1.2 Research objectives

This thesis aims to identify the considerations relevant for determining the desirability of harmonising parts of private law for the benefit of the internal market. It intends to offer a framework for determining whether and when harmonising parts of private law to improve the functioning of the internal market is necessary and desirable.

The underlying idea is that a more careful assessment of new EU proposals for harmonisation may be one way to address EU legitimacy problems and Euroskepticism - although certainly not the only one. This idea is not new: Brussels has included several ways to enhance the scrutiny on new EU rules. The principles of subsidiarity and proportionality,[15] and the use of impact assessments, consultations and Better Regulation programs generally, are intended to enhance transparency and pressure EU legislators to convince the Member States and citizens of the need of EU legislation.[16] Nevertheless, the way in which these procedural safeguards are applied in practice, as illustrated by the statement from an Impact Assessment quoted above, suggests that EU policy making is currently not based on a comprehensive test of the costs and benefits of harmonisation.

These costs and benefits do not only include obstacles to the internal market, but also other legal and economic considerations that will be discussed in this thesis, such as the costs and benefits that the substantial rules represent to their users, heterogeneous preferences of citizens, and the effects of harmonisation on the coherence of Member States' systems of private law. Aiming to offer a more comprehensive test for harmonising rules for the benefit of the internal market, this thesis addresses the following main research question:

> *Which considerations should be taken into account, from a Law and Economics perspective, when determining whether it is necessary and*

[15] Laid down in Article 5, paragraphs 3 and 4 of the Treaty on European Union. See further chapter 2.

[16] See further chapter 2.

desirable to harmonise aspects of private law for improving the functioning of the internal market?

In answering this question, the thesis focuses on three specific legislative initiatives of the EU in the field of private law, which are each based on the legislative competence for the internal market:[17] the Consumer Rights Directive (2011), the Antitrust Damages Directive (2014) and the Proposed Digital Contracts Directives (2015).

The reason for choosing the internal market's legal competence of Article 114 TFEU and policies affecting Member States' private law as the focus of this research is twofold. First, Article 114 TFEU is one of the broadest legislative competences, due to the fact that it is defined in terms of its objective, rather than its subject matter.[18] This means that this competence allows the EU to act in a wide range of policy areas, making it one of the main drivers of further harmonisation. It also means that the EU has a broad discretion in choosing which areas of law to harmonise under this legal basis, leaving the Member States with relatively little control over new EU policy. These aspects make harmonisation based on the internal market's legal competence particularly relevant for the societal questions and concerns regarding deeper EU integration discussed above. Secondly, since there is no comprehensive legal basis for the EU to harmonise private law, many initiatives affecting private law are enacted under Article 114 TFEU. Additionally, as was discussed private law is an area where harmonisation is viewed critically by many Member States. This makes this area particularly relevant in the context of limiting harmonisation to those areas and aspects where citizens deem it desirable and acceptable.

In order to answer the research question, the thesis employs several methods. It relies on economic models of trade and game-theoretic approaches, as well as methods of comparative law and legal discourse. It connects the fields of economics

[17] To be precise, these EU measures have a dual legal basis, meaning that they are based on Article 114 TFEU in combination with another legal basis.

[18] See further chapter 3.

of integration and the economic theory of federalism in order to shed more light on the need for positive integration to complete the internal market. The thesis primarily takes a theoretical perspective on how the various European initiatives are likely to affect the internal market as well as welfare, using trade models and game theory. Additionally, survey data were used to compile an empirical overview that helps to explain the assumptions underlying the theoretical model. The thesis also makes use of comparative legal methods to provide an overview of Member States' rules that offers insights into the effects of harmonisation in each of the Member States.

The thesis aims to draw conclusions as to an appropriate test for when harmonisation based on improving the functioning of the internal market is desirable. Ultimately, the objective of the research is to contribute to better policy making, and to moving towards a welfare-enhancing level of European harmonisation in the area of private law.

1.3 Overview of the thesis

The thesis is structured as follows. The next chapter of the thesis, chapter 2, considers the question under what conditions harmonisation should take place. The chapter addresses this question from both a legal and an economic perspective. The legal criteria for harmonisation are laid down in the principles of conferral, subsidiarity and proportionality. Different legal views on the meaning of subsidiarity are discussed, and an economic, efficiency approach to subsidiarity is proposed. Next, the economic criteria for harmonisation are discussed as elaborated in the economic theory of federalism and the literature on regulatory competition and public choice.

In chapter 3 the thesis aims to connect the economics of federalism to the internal market. This involves the question of how the economic theory of integration, and particularly increased trade, compares to the criteria for harmonisation elaborated in the economic theory of federalism. It also includes an analysis of how

the economic arguments for (de)centralisation compare to the legal considerations behind the legal basis for the internal market, as enshrined in the principles of subsidiarity and proportionality, and based on the scope of the legislative competence for internal market harmonisation laid down in Article 114 TFEU. Using a Brander-Krugman reciprocal dumping model, the chapter illustrates the impact of legal harmonisation on trade. This chapter aims to demonstrate that in determining the effects of harmonisation on firms, not only transaction costs savings related to differences in rules, but also costs to comply with legal rules should be taken into account.

Chapter 4 builds upon the findings in chapter 3, and extends the analysis to include heterogeneous preferences of consumers. The chapter considers the question of how trade benefits compare to welfare benefits of harmonisation, using a vertical differentiation model. Against the background of the Consumer Rights Directive and the Digital Contract Directives, the chapter aims to demonstrate that reducing variation in legal rules does not necessarily improve welfare, even if it improves the functioning of the internal market as measured by increased trade. The reason is that while harmonisation may enhance competition and lower prices by reducing transaction costs related to legal fragmentation, it also reduces the variety of legal standards, thereby lowering consumer surplus when consumers differ in their preferences for these legal standards.

Chapter 5 and 6 consider specific aspects of the content of harmonised rules in the Antitrust Damages Directive. Chapter 5 concerns the impact of harmonising the rules on limitation periods, in light of the the goal of providing a 'level playing field' for antitrust damages claims in the European Union. It finds that, besides the substance of these rules, and Member States' different preferences for rules on limitation periods, the effects of harmonisation also depend on the scope of the European instrument. The reason is that if the European instrument does not cover all rules relevant to a certain situation, from the perspective of the users of these rules, Member States' rules will continue differ. This may undermine the goal of the European instrument to provide a common framework throughout the EU.

Chapter 6 considers the relevance of enforcement in light of the effects of harmonisation: the interplay between public and private enforcement of competition law. The chapter analyses the impact of harmonising the rules on antitrust damages, that aim to encourage private damages actions, against the background of the deterrence of anti-competitive behaviour by means of public enforcement. Using a game-theoretic approach, the thesis finds that private enforcement may reduce the attractiveness of the leniency program[19] and thereby potentially undermine public enforcement. A comparison with the U.S. is made, where different rules on private liability are in place that aim to protect the interests of reporting firms in order to preserve the leniency program.

Chapter 7, finally, offers conclusions, discusses the policy considerations and implications of the findings in this thesis and outlines possible avenues for future research.

[19] The leniency program offers cartel members immunity from the fine or reduced fines in return for reporting the cartel and handing over the evidence to convict the other cartel members. See further chapter 6.

Chapter 2

Legal and Economic Aspects of Harmonisation

The purpose of this chapter is to set the stage, by presenting the relevant legal and economic framework for harmonisation that forms the basis for the subsequent chapters. Section 2.1 details the legal framework for European harmonisation, discussing the principles of conferral, subsidiarity and proportionality, explaining the origins and meaning of subsidiarity, and summarising the critique on its application. Various rationales for subsidiarity are discussed, and the view of subsidiarity as an efficiency principle is advocated. This economic view of subsidiarity originates in the economic theory of federalism. Section 2.2 offers a literature review of this stream of literature, discussing the advantages of centralisation and decentralisation, the theory of regulatory competition and insights from the political economy literature.[1] Section 2.3 provides the main insights of this chapter that are relevant for the subsequent chapters in this thesis.

[1] The other main economic theory regarding EU integration, the theory of economic integration, is discussed in detail in chapter 3.

2.1 The subsidiarity principle

2.1.1 Legal criteria for harmonisation

Harmonisation in the European Union is governed by the principles of conferral, subsidiarity and proportionality. The European Union, unlike a nation state, only has those competences that have been conferred upon it. Article 1 of the Treaty on European Union (TEU, or Lisbon Treaty)) states that 'the Member States confer competences to attain objectives they have in common'. Article 4, paragraph 1 TEU declares that 'competences not conferred upon the Union in the Treaties remain with the Member States'. Article 5 TEU lays down the principle of conferral, stating that '[t]he limits of Union competences are governed by the principle of conferral' (paragraph 1). This means that 'the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein'. It is repeated that '[c]ompetences not conferred upon the Union in the Treaties remain with the Member States'.[2]

In accordance with the principle of conferral, every binding act the Union adopts must have a legal foundation in the Treaties or in a pre-existing normative act. The Treaties specify the legal bases for the competences that have been conferred upon the Union. Although the Union competences are often widely drawn, they are nonetheless delimited by material and procedural restrictions (Barnard and Peers, 2014, 106). Two competences have been phrased in terms of pursuing objectives, namely those of establishing and pursuing the functioning of the internal market (Article 114 TFEU) and of attaining Union objectives where the necessary powers have not been provided elsewhere (Article 352 TFEU). The latter requires a unanimous vote in the Council and, as a result, is rarely relied upon. By contrast, the former only requires qualified majority voting and is used widely,

[2] The principle of conferral reflects the seminal judgement of Case C-26/62 *Van Gend en Loos* [1963] ECR 3. In this case, the Court of Justice stated that 'the [EU] constitutes a new legal order of international law for the benefit of which the States have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only Member States but also their nationals'.

which at times triggered debate on the boundaries of this competence.[3] Under Article 114 TFEU, legislative measures can be adopted using the ordinary legislative procedure, laid out in Article 289 TFEU. Under this procedure, the European Commission can submit a proposal for a legislative act - a regulation, directive or decision - which has to be approved by the European Parliament and the Council. These bodies each have the possibility to amend the proposal. The Council represents the governments of the Member States and can act by qualified majority, meaning that proposals can go forward even if some Member States disagree.[4]

The competences of the Union are classified in three categories: exclusive, shared and ancillary competences.[5] Articles 2 to 6 TFEU specify for the various domains of activity of the Union what type of competence the Union has to act.

Regarding exclusive competences, 'only the Union may legislate and adopt legally binding acts', as stated in Article 2 TFEU. In ancillary competences, the Union may 'carry out actions to support, coordinate or supplement the actions of the Member States'. The exercise of an ancillary competence may not itself lead to harmonisation, as specified in Article 2, paragraph 5 TFEU. The residual category, containing the majority of competences of the Union, is that of shared competences. With respect to these competences, 'Member States shall exercise their competence to the extent that the Union has not exercised its competence'. Competences are thus rather concurrent than shared, in that Member State action is pre-empted once the Union has adopted rules on a particular matter (Barnard and Peers, 2014, 108).

In relation to shared and ancillary competences, Union action is constrained by the principles of subsidiarity and proportionality, laid down in Article 5 TEU. The subsidiarity principle is defined as follows in Article 5, paragraph 3 TEU:

[3] See further chapter 3 below.

[4] See Article 294 TFEU.

[5] Additionally, two areas of competences are excluded from these categories because of their special character: the power to adopt arrangements for the coordination of the Member States' economic and employment policies, and the competence to implement a common foreign and security policy. See further Barnard and Peers (2014), in particular section 4.4.4 and chapter 19.

> 'Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.'

Importantly, the subsidiarity principle in EU law thus does not deal with the question of which powers should be conferred upon the EU. It rather asks whether the powers that do fall within the EU sphere should in fact be exercised (Bermann, 1994, 366). Moreover, its role is limited to the non-exclusive powers of the EU.

Under the principle of proportionality, 'the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.' (Article 5, paragraph 4 TEU). The proportionality principle has a constitutional function, and failure to comply with it a ground for review of a Union act by the European Courts. When assessing the proportionality of a Union act, the Court analyses the suitability, necessity and proportionality of a Union act. The first part of the test concerns the question of whether the measure is in fact suitable to achieve the given objective. The necessity test requires that the act adopted represents the least restrictive means to achieve the objective. Finally, to meet the proportionality test it must be shown that even the least restrictive means to achieve the policy objective does not disproportionately interfere with individual rights. While this test is very strict in theory, the Court has granted the European policy maker a wide margin of appreciation, and rarely finds an EU measure to be disproportionate.[6] This has led some commentators to question whether the Court in some areas is interpreting the proportionality principle in a way that undermines its function (Harbo, 2010). The role of the principle of proportionality will be touched upon in section 3.3.2 in chapter 3, in relation to the internal market.[7]

The remainder of this chapter will focus on the subsidiarity principle. In order to distil the role subsidiarity can play in guiding harmonisation, the next sections

[6] See further Schütze (2012, 267-268) and the case law cited therein.

[7] Regarding the meaning and the role of the proportionality principle, see further e.g. Sauter (2013) and Harbo (2010).

consider the origins of subsidiarity, as well as the different views as to its meaning.

2.1.2 Origins of subsidiarity

The origins of subsidiarity can be traced back to the Catholic model of subsidiarity, found in various papal encyclicals (Barber, 2005, 309; Cass, 1992, 1111).[8] In Quadragesimo Anno, Pope Pius XI provided a statement of the meaning of subsidiarity within Catholic philosophy:[9]

> '[T]hat most weighty principle, which cannot be set aside or changed, remains fixed and unshaken in social philosophy: Just as it is gravely wrong to take from individuals what they can accomplish by their own initiative and industry and give it to the community, so also it is an injustice and at the same time a grave evil and disturbance of right order to assign to a greater and higher association what lesser and subordinate organizations can do.'

Subsidiarity captured both the idea that the state should not intervene unless it was necessary and the idea that the state should intervene when it was necessary. Although not directly concerning power division between levels of government, the early concept of subsidiarity does contain the seeds of the current questions regarding decentralisation and centralisation (Cass, 1992, 1111-2).

In the context of the European Union, the subsidiarity principle first surfaced in the 1975 Report on European Union submitted to the Council of Ministers by the European Commission.[10] The subsidiarity principle then featured in the Draft Treaty on European Union produced by the European Parliament in 1984, where it was included as a general constitutional rule. Regarding concurrent competences, the Union was only 'to carry out those tasks which may be undertaken more effectively in common than by the Member States acting separately.'[11] The Draft

[8] On the Catholic origins of subsidiarity see further Emiliou (1992); Peterson (1994); Henkel (2002); MacCormick (1999).

[9] Pope Pius XI, Quadragesimo Anno (1931), paragraph 79.

[10] Commission Bulletin of the European Communities, Supplement 5/75 at pp. 10-11.

[11] Draft Treaty Establishing the European Union, art. 12(2), 1984 O.J. (C 77) 33, 38.

Treaty however proved far too ambitious and was abandoned in favour of the more modest Single European Act (SEA), signed in 1986. In the SEA, the subsidiarity principle first found official expression, albeit in the domain of environmental protection only. The SEA stated that 'The Community shall take action relating to the environment to the extent to which the objectives [assigned to it] can be attained better at [the] Community level than at the level of the individual Member States.'[12]

In 1989 Jacques Delors, then President of the European Commission, advocated subsidiarity as a primary tool of the integration process, naming it 'a way of reconciling what for many appears to be irreconcilable: the emergence of a United Europe and loyalty to one's homeland' as well as a 'golden opportunity for the joint exercise of sovereignty, while respecting diversity and hence the principles of pluralism and subsidiarity'.[13]

The principle acquired general application in 1992 with its inclusion in the Maastricht Treaty on European Union:[14]

> 'In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community.'

The 1992 Treaty on European Union also stated that 'decisions are [to be] taken as closely as possible to the citizen' (Article A) and that the Community institutions were to respect the principle of subsidiarity (Article B). The increased importance of subsidiarity can be attributed to the shift from unanimity voting to a system of qualified majority voting with the SEA. The new decision making rules marked the initial loss of grip of Member States on the Community legislative

[12] EC Treaty art. 130r(4) (as amended 1987).
[13] Address by Jacques Delors, Opening Session of the 40th Academic Year of the College d'Europe, Bruges 17 Oct. 1989.
[14] EC Treaty, Article 3b.

process (Bermann, 1994, 362-363).[15] At the same time, the 1980s and 1990s saw an upsurge in literature questioning the EU's legitimacy (Craig, 2012, 73). The widespread belief that further integration was needed to achieve the internal market made way for scepticism among Member States when it became clear that the possibilities for harmonising new policy areas were great (Bermann, 1994, 364). Subsidiarity offered the Member States a new instrument to control the Commission (Bermann, 1994, 345). Subsidiarity is also said to have been included in the Maastricht Treaty in order to accommodate those Member States who feared that too much power was shifting from the national to the European level (Barber, 2005, 314).[16] With Maastricht, the new EU appeared to have reached the limits of integration that all Member States could accept. The economic problems faced by the EU in the early 1990s further eroded public opinion on expanding EU powers (Medrano, 2012, 198). This was also illustrated by the Danes' rejection by referendum of the Maastricht Treaty. One of the tasks of the European Council at the Edinburgh Summit, held on 11 and 12 December 1992, was to clarify how subsidiarity would be secured. The usefulness of subsidiarity had to be demonstrated in order to reassure the Member States that their interests would be taken into account (Bermann, 1994, 368-8).

As the areas in which the EU was empowered to act gradually expanded, the application of the principle of subsidiarity developed and changed. Cass (1992) distinguishes three phases of the subsidiarity principle. In the phase of its adoption, the principle was primarily focused on the capacity of government and finding a fairer allocation of power. Once it had gained general application, subsidiarity served as a criterion to ensure an efficient and effective allocation of tasks in the European Union. In its third phase, subsidiarity was seen as a balancing devise for power allocation, although views differed regarding the direction the shift of allocation of powers should take (Cass, 1992, 1127-8).

[15] According to Breton et al. (1998, 49), the qualified majority voting rules were conducive to centralisation.

[16] See also Wilke and Wallace (1990) and Estella (2002).

The more competences were transferred to the Union, the more developed became the legal framework of the principle of subsidiarity (Constantin, 2008, 155). A Protocol on the Application of the Principles of Subsidiarity and Proportionality was attached to the Treaty of Amsterdam, signed in 1997. The Protocol clarified a number of things, including that the subsidiarity principle was meant to be a dynamic concept: 'Subsidiarity is a dynamic concept and should be applied in the light of the objectives set out in the Treaty. It allows Community action within the limits of its powers to be expanded where circumstances so require, and conversely, to be restricted or discontinued where it is no longer justified.'[17]

The Lisbon Treaty included additional procedural safeguards to ensure compliance with subsidiarity. National parliaments were given the role of 'subsidiarity watchdog'. The second Protocol to the Lisbon Treaty outlines the mechanisms for this parliamentary scrutiny.[18] Article 5 requires that all draft legislative acts 'shall be justified with regard to the principles of subsidiarity and proportionality' in a detailed statement. Articles 6 and 7 of the Protocol contain the 'early warning mechanism', through which national parliaments can scrutinise draft legislation: if one third of the Member States' national parliaments raises an objection (a so-called 'yellow card') on the basis that the principle of subsidiarity has been violated, the proposal must be reviewed. If a majority objects (a so-called 'orange card'), the Council or Parliament can vote the proposal out immediately. While this mechanism requires a high threshold for review of potential legislation, the opposition of a significant number of Member States can exert political pressure against moving forward with the proposal. Therefore, the existence of the early warning system has been argued to act as a deterrent against legislative proposals which threaten the principle of subsidiarity (Barton, 2014, 87).

17 Article 3 of the Protocol.

18 Protocol on the application of the principles of subsidiarity and proportionality to the Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community ('Protocol') [2007] OJ C306/150.

2.1.3 Today's meaning of subsidiarity

Today, the subsidiarity principle is enshrined in Article 5, paragraph 3 of the TEU, as was explained in section 2.1.1. It requires that for shared and ancillary competences of the EU, the EU acts only if and insofar the objectives of the proposed action cannot be sufficiently achieved by the Member States, and can be better achieved at the EU level by reason of the scale or effects of the proposed action. The subsidiarity principle thus provides a two-legged test, limiting Union action to situations in which i) Member States cannot sufficiently achieve the objectives of the proposed action and ii) the EU can better achieve the objective. This subsection details how this wording should be interpreted, and it discusses the critique that has been expressed on its vagueness as well as the way in which the principle is applied.

Schütze (2012, 178) considers the wording of Article 5(3) TEU to be a textual failure, and he is not alone in his criticism. The first part of the test that permits Union action only if and in so far as Member States cannot fulfil the objectives sufficiently appears to be an absolute standard, but the term 'sufficiently' is intrinsically subjective (Barton, 2014, 84). According to Craig (2012, 72-3), the term 'sufficiently' was initially thought to reinforce the use of subsidiarity to avoid excessive centralisation, since it would ensure that policies would remain national as long as Member States could achieve the objective adequately on their own. The second limb complicates criteria further, since it requires that the Union may act if, in doing so, the objective can 'be better achieved'. The word 'better' has also been criticised for being subjective and offering only a 'vague and general' test (Estella, 2002, 95). The text does not clarify what ought to happen in situations in which an objective can be sufficiently achieved by Member States but in which Union action would be superior (Barton, 2014, 95; Schütze, 2012, 178; Ripley et al., 2012, 220).

The critique that the wording of the subsidiarity principle is vague was already expressed at the time of its inclusion in the Maastricht Treaty. Because of its lack of clarity, the subsidiarity principle was said to be fundamentally incapable of serv-

ing as a guiding principle for harmonisation (Adonis and Tyrie, 1993; Geelhoed, 1991). The wording was considered to be open to many different interpretations, so that the principle did not provide guidance on the question of the assignment of powers to different levels of government (Breton et al., 1998, 23; Cass, 1992, 1134). Moreover, the term 'better' was labelled a 'deliberately elusive term' (Macrory, 1992, 225). Bermann (1994, 335) nevertheless concluded that 'while elusive and sometimes deeply confusing, subsidiarity is a meaningful and useful notion' if it is 'practised as well as preached'. Constantin (2008, 169) concludes that, in the Lisbon Treaty, subsidiarity has simply remained 'the vague and elusive norm it has always been'.

Next to the critique of vagueness, the subsidiarity principle has also been criticised because it can be used to support expansion of competences of the EU as well as to defend national sovereignty. According to some commentators, the principle was initially used to justify the enlargement of the competences of the EU, and only later turned into a principle to limit the expansion of EU powers (Breton et al., 1998, 23; van Kersbergen and Verbeek, 1994, 216). Barber (2005, 311-312) finds that the wording of subsidiarity in the Treaty of Amsterdam created a bias in favour of Member States, because it required both the realisation of efficiency gains by harmonisation, and imposed the condition that the benefits of EU action would outweigh the preference for state action.

One may question whether these criticisms are sufficient reason to discard the subsidiarity principle. Some vagueness is inherent in a general principle. Similarly, since the principle intends to give guidance as to the appropriate level of integration, it is to be expected that the principle can be used to defend both sides of further integration (Van den Bergh, 1994, 40).

A more pressing criticism is that subsidiarity does not give much guidance to harmonisation if it is not applied rigorously in practice. At the time of its introduction, it was noted that in order to be taken seriously, subsidiarity had to direct a genuine inquiry into the consequences of EU action as compared to Member State action. Bermann (1994, 335) predicted that EU institutions would have

difficulty demonstrating that subsidiarity had been complied with, since this entails predicting the consequences of a particular policy, which he considered to be an exercise in speculation as well as judgement. Cass (1992, 1132) wondered how the EU policy maker would judge the scale and effect of, for example, consumer protection measures or safety legislation. The use of impact assessments in the last years has shown, however, that while it may not be possible to predict the magnitude of the impact of a policy, estimations can be made of its effects that can help to determine its desirability. While it might thus be difficult to set a priori clear and strict criteria for applying subsidiarity, the compliance with subsidiarity of new policies can be considered on a case-by-case basis (Constantin, 2008, 152-157).

Nevertheless, various commentators find that subsidiarity has not been a useful tool to balance the allocation of powers and has had little effect on restraining the power of the European institutions (Barber, 2005, 324; Constantin, 2008, 151). According to Constantin (2008, 171), subsidiarity tends to work as a principle for structuring the political discourse instead of functioning as an instrument for operationalising the exercise of competences and the protection of national interests in the EU. It is the political arena where, in her view, the competences between the EU and its Member States are demarcated in daily practice, balancing national discretionary powers rather than the framework of subsidiarity. Indeed, it appears that subsidiarity involves political judgement about whether to exercise a conferred competence (Weatherill, 2004a, 16). It has even been said that the principle of subsidiarity can be 'moulded to suit virtually any political agenda' (Peterson, 1994). Hojnik (2012, 137) considers this to be the result of the fact that the principle was included in the Treaties as a political compromise to assure acceptance by the Member States and not actually to limit the competences of EU institutions.[19] Wyatt (2003, 92) also concludes that the EU institutions have been reluctant to give full practical effect to subsidiarity because they consider

[19] Hojnik refers to European Commission, 'The Principle of Subsidiarity', Commission Communication to the Council and the European Parliament, SEC (92) 1990 final, 27 October 1992.

that it runs against EU integration. The respect within the institutions for subsidiarity may be outweighed by the institutional tendency to increase the scale of their activities rather than reduce them. Wyatt finds little evidence in support of the principle of subsidiarity having significantly altered the behaviour of the institutions or reduced the volume of legislation.

Others have called for reforms to improve the application of subsidiarity in practice. Some of these suggestions for improvements have by now been incorporated, such as guidelines on how to make the subsidiarity assessment in the protocol to the Lisbon Treaty, and the mandatory discussion of less intrusive alternatives for the policy in impact assessments (Bermann, 1994, 379; Barton, 2014, 85-87).

2.1.4 Views on the rationale for subsidiarity

The critique on the concept of subsidiarity and its application raises the question of what the role of subsidiarity ought to be. Subsidiarity was intended to aid the resolution of issues regarding the balance between centralisation and decentralisation in the EU, and ensure that the division of power between the various levels of government is respected (Craig, 2012, 73-4).[20] But to answer the question of what is to be expected from the subsidiarity principle, and how it should be applied, we need to examine the reasons for applying the subsidiarity principle. One might argue that the limited scope of the EU's legislative competences and the procedural requirements for adopting a legislative proposal offer sufficient limits to EU policy making. Put differently, one might ask why, once a legislative proposal has been approved by the European Parliament and Council of Ministers, we need subsidiarity. In the scholarly literature, various rationales for subsidiarity have been identified.

Craig (2012) distinguishes several rationales for subsidiarity within the EU. Craig's first rationale is that subsidiarity is meant to help prevent excessive use of power by the EU. This rationale has been named by other scholars as well, such as Bermann

[20] See also Coglianese and Nicolaidis (2001) and Kelemen (2009).

(1994, 331), who sees subsidiarity as a check against tyranny. Bermann notes that self-determination and accountability are better ensured under localised decision making. Subsidiarity has been called an attempt to balance the 'historic, nationalist, sovereignty-obsessed' characteristics of individual Member States against the European Union's integration objectives (Barton, 2014, 83), and to 'prevent a complete infantilization of national governments' (Davies, 2006, 63).

Craig's second rationale for subsidiarity involves the promotion of diversity among different constituencies. This aspect of maintaining diversity by limiting federal powers can be observed in many different literatures. In the literature on the economics of federalism, the correspondence of policy with local preferences is a key notion, as will be discussed in section 2.2.1 below. Also in the legal literature, many see subsidiarity as a way to preserve the cultural and political identities of the Member States. As Neuman (1995, 573) puts it, Member States did not intend to merge into a great EU 'melting pot' governed by a centralist bureaucracy. Subsidiarity can be seen as a way to offer flexibility to national governments to create laws which are better adapted to their individual economic, social, political and cultural circumstances (Bermann, 1994, 340).

Others focus on the function of the subsidiarity principle for the democratic legitimacy of EU decision-making.[21] Barton (2014, 84-97) notes that subsidiarity is in the Union's own interest, to preserve its image as a democratic institution and ultimately its acceptance by citizens. In her view, subsidiarity is vital to enable effective legislation at the EU level only where necessary. Bermann (1994, 366-7) characterises the rationales for subsidiarity as legislative, interpretative and as an element of legality of EU action. Hojnik (2012, 141) sees the principle of subsidiarity as an answer to the democratic legitimacy deficit in the EU, by assuring high quality and democratically legitimate EU law. Similarly, Barber (2005, 308,313) views subsidiarity as a principle regarding the functioning of democracy, concerned with the allocation of powers in existing institutions as well as with the creation of new bodies.

[21] See e.g. Scott and Trubek (2002, 8)

Summarising, the rationales for subsidiarity can be characterised as serving as a safeguard against excessive EU power, promoting diversity, and ensuring the democratic legitimacy of EU policy-making. The question remains of how the subsidiarity principle should be interpreted in order to fulfil these rationales. It appears that in order to serve democratic legitimacy of EU policy making, subsidiarity needs to be applied carefully and consistently. As to the first two rationales, it appears that subsidiarity should involve a balancing exercise between the advantages and disadvantages of EU action, in order to guarantee that harmonisation is not excessive, and promotes diversity. The next subsection discusses the considerations that should be included in this view of subsidiarity as an efficiency principle.

2.1.5 Subsidiarity as an efficiency principle

From an economic perspective, subsidiarity ought to reflect the notion that action should be taken at the level of government at which it can most effectively be exercised, or at which the objectives of the action can adequately be achieved. The relevant question for subsidiarity is whether centralisation of a certain task or policy is necessary. The starting point is that decentralisation is preferable since it allows for more diversity, representing citizens' heterogeneous preferences, and for better policy making, as is discussed in section 2.2.1 below. Only if lower levels of government fail to provide an efficient level of a public good or policy, centralisation of certain tasks is warranted. From a Law and Economics point of view, therefore, the burden of proof for harmonisation should lie with the central government. In this context, the subsidiarity test is only useful if it is accepted as a functional one which informs political decision-makers about costs and benefits of further (de)centralisation (Pelkmans, 2006b, 9). Pelkmans stresses that the subsidiarity test should be distinguished from the ultimate decision to (de)centralise: this decision should be political. The subsidiarity test should be a functional underpinning of the ultimately political decision. Being a functional test, the principle of subsidiarity is thus neutral about the resulting

degree of centralisation: it does not necessarily dictate delegating power to the lowest possible level. The subsidiarity test involves an assessment of the optimal level at which decisions should be taken, which can result in centralisation but also in decentralisation (Ederveen et al., 2008, 20).[22]

An important difference between the economic and the legal approach to integration is that economists ask whether centralisation is necessary, while lawyers often consider whether the EU should show reluctance, given that Member States would be able to perform certain competences themselves (Van den Bergh, 1994). Nevertheless, many legal views on subsidiarity reflect the economic approach discussed above, even when an economic approach is being rejected. For example, Hojnik (2012) finds that the principle of subsidiarity should ensure that in balancing the division of powers between the EU institutions and its Member States, the preservation of national traditions and cultures is taken into account. Hojnik rejects economic effectiveness as a general basis for deciding between institutional alternatives in the EU, on the basis that economic effectiveness would always dictate the unification of rules to serve the internal market. The criterion for harmonisation in Hojnik's view, however, closely represents an economic view of harmonisation when she notes that 'A certain degree of uniformity and the removal of hindrances are necessary for the EU economy, but still it is an undeniable fact that the Member States are diverse and thus uniform rules are not always appropriate from the democratic legitimacy point of view.' Other legal scholars emphasise that subsidiarity is a manifestation of the Member States' aspiration that 'decisions [be] taken as closely as possible to the citizen', thus expressing a preference for government at the most local level (Barnard and Peers, 2014, 110; Bermann, 1994, 338-9). In the view of Barber (2005, 318), efficiency only obtains meaning if seen in light of the objectives set by political philosophy. For example, the efficiency test in the European principle of subsidiarity is guided by the objective of ensuring flourishing democratic government. However, from an economic perspective efficiency certainly has meaning on its own, and is guided by considerations of welfare. Nevertheless, the view of subsidiarity as an efficiency

[22] See also Pelkmans (2005).

principle can indeed serve the rationale of ensuring democratic legitimacy.

In the view of Van den Bergh, the formulation of the subsidiarity principle in the Maastricht Treaty already left much room for efficiency considerations, and even had an implicit economic logic (Van den Bergh, 1994, 351). The phrase 'creating an ever closer union among the peoples of Europe, in which decisions are taken as closely as possible to the citizen' in Article A paragraph 2 EU Treaty represents the economic rule in favour of diversity, and hence decentralisation. Similarly, Pelkmans (2006b, 7) finds that the definition of subsidiarity in the Amsterdam Treaty was broadly in line with the basic economics of subsidiarity. The Treaty specifies the requirement to demonstrate a need to act in common, as given by the existence of either economies of scale or cross-border externalities. Moreover, it requires any action to be proportional to the desired objective, a logical corollary to the primacy of decentralisation. The Treaty of Nice requires that an EU action can 'by reason of the scale or effects of the proposed action, be better achieved by the Community' (Article 3 B EC Treaty). This can be viewed as an efficiency test, focusing on the effects of rules. The formulation allows for the consideration of scale economies and externalities (Van den Bergh, 1994, 351).

Translating these views to the Lisbon Treaty, such efficiency considerations can still be found: the principle that the Union shall act only if and insofar as an objective cannot be sufficiently achieved by the Member States reflects the economic rule in favour of decentralisation. The provision explicitly mentions economic reasons for harmonisation: the phrase 'scale or effects' can arguably be read as scale economies or cross-border effects. Finally, the term 'better' still invites a cost-benefit analysis. However, as was discussed in subsection 2.1.3, since the definition of the subsidiarity principle contains two cumulative criteria, it is not clear whether an efficiency test only comes into play once it has been established that the Member States cannot achieve the objectives of the action sufficiently on their own. In such a reading of the provision on the subsidiarity principle, Union action is only submitted to an effectiveness test, and not a test of comparative efficiency of Union and Member State action. Van den Bergh already noted this lack of clarity as to whether the definition of subsidiarity contains a test of comparative

efficiency with respect to the EC Treaty (Van den Bergh, 1994, 351-2).

In short, while the legal definition of subsidiarity offers some room for an economic approach to this principle, it does not clearly reflect a test of comparative costs and benefits of decentralisation and centralisation. The next question is what such an economic test does entail, which question is addressed in the economics of federalism literature discussed in the next section.

2.2 Economic considerations for harmonisation

2.2.1 Economics of federalism

The economic theory of fiscal federalism explores how much centralisation or decentralisation is desirable in a multi-level system of jurisdictions. The theory asks what the optimal vertical assignment of competences of public policies and taxes is in order to maximise welfare. The economic theory of fiscal federalism finds its foundation in Musgrave (1959), who discusses the optimal level of centralisation for various branches of public economic functions: allocation, distribution and stabilisation. Later on, the theory has been extended to study the harmonisation of legal rules.

Some of the key economic arguments in favour of and against federalism were developed by Oates (1972) and Brennan and Buchanan (1980). Oates (1972) presents two central theorems regarding the allocation of tasks to vertical layers of government. According to the *decentralisation theorem*, 'each public service should be provided by the jurisdiction having control over the minimum geographical area that would internalise benefits and costs of such provision' (Oates, 1972, 55). The *correspondence principle* holds that 'the jurisdiction that determines the level of provision of the public good includes precisely the set of individuals who consume the good [so as to] internalise the benefits from the provision of each good' (Oates, 1972, 34). Put differently, as a starting point the task of providing a public good should be allocated to the lowest level of government possible, and those who

benefit from it should also be the ones paying for its provision. The second aspect reflects the principle of *fiscal equivalence* proposed by Olson (1969), according to which political jurisdiction should overlap with the area that benefits from the public service, in order to ensure that marginal benefit of its provision equals its marginal costs, and free riding is avoided. The theory advanced by Oates relies on three assumptions. First, each level of government always acts benevolently, maximising the welfare of its constituency, and is perfect, in the sense that it does not incur costs in designing policy. Secondly, the central government applies a uniform policy across all jurisdictions, due to costs of gathering information and political constraints that prevent it from treating jurisdictions differently. Finally, each governmental layer acts as a single decision maker.[23]

Decentralisation of public tasks has the benefit of allowing policies to be diversified across regions according to the local preferences. Citizens may have heterogeneous preferences regarding the need for governmental intervention as well as the type of policies because of, for example, different cultural, geographical, and economic conditions. If one uniform policy applies to all citizens, the content of this policy will necessarily be a compromise. Dividing the population into smaller groups is likely to result in less compromise: the policy will better match citizens' preferences, improving economic welfare.[24] Lower levels of government may be better able to tailor their policies to local preferences, because they may have better information on local interests than a remote central government. Moreover, citizens may be better able to hold local policy makers accountable, as compared to a central government. Another advantage of decentralisation is that it may be possible to reduce bureaucracy and lower planning costs (Eichenberger, 1994).

From a dynamic perspective, a decentralised system has the advantage of allowing jurisdictions to improve their laws by learning from the experiences of others (Ederveen et al., 2008). This idea also underlies 'laboratory federalism', which emphasises the advantages of experimentation with different rules in a decentralised system. This idea can be traced back to Hayek's concept of competition as a

[23] See further Oates (1999), Oates (2001) and (Oates, 2005).
[24] *Cf.* Quigley (1997).

discovery process, which can improve our limited knowledge about the optimal legal rules (Hayek, 1945). A downside of centralisation is that these possibilities for experimentation and mutual learning are eliminated. In this light, Kerber (2000) emphasises to be cautious about harmonisation unless the appropriate legal solution to the problem is known.

The main reasons that may call for centralisation are the existence of economies of scale and cross-border externalities, also called spillover effects (Oates, 2005). Economies of scale may be realised when the average costs of a public task can be reduced by increasing output. When fixed costs of the policy are high, a central government may be able to provide it at a lower cost to all constituencies than local governments to each of their constituencies. Additionally, centralisation may save transaction costs.[25]

Cross-border externalities arise when the policy of one jurisdiction has effects in another jurisdiction that are not taken into account by the local government of the first jurisdiction. Such spillover effects may be positive or negative. Positive externalities imply that the investments in a policy of a jurisdiction benefit other jurisdictions as well. These additional benefits are not taken into account by the first jurisdiction, leading to an inefficiently low level of investment in these type of policies, or free riding on the part of both jurisdictions. In policy areas that create negative cross-border spillovers, the opposite happens: local governments tend to invest more, or allow more, than would be efficient, because they fail to take into account the costs of their policy to neighbouring constituencies. A central government will be able to internalise the cross-border effects and provide the efficient level of the policy.

Besides internalising spillovers and exploiting scale economies, centralisation also has the advantages of allowing for better coordination of policies and allowing for redistribution (Eichenberger, 1994). At the same time, the adaptations in the law required for centralisation may be very costly (Ogus, 1999). The main cost of centralisation, however, is that it reduces the responsiveness of policy to citizens'

[25] See further e.g. Schäfer (2006).

preferences.

2.2.2 Regulatory competition

The theory of regulatory competition offers an explanation as to why local governments would be more responsive to citizens' preferences for public goods and policies than central governments. It takes as a starting point that, like in markets for private goods, competition between governments can improve policy making. The theory roots in the seminal article by Charles Tiebout on the provision of public goods (Tiebout, 1956). According to Tiebout, if citizens relocate to their preferred jurisdiction on the basis of their preferences for public goods, this mobility can inform local governments about their preferences, and improve the responsiveness of governments to these preferences. Consequently, if citizens choose the jurisdiction offering their preferred set of public goods, this will induce beneficial competition between jurisdictions to attract residents by offering policies that match their preferences. This interjurisdictional competition guarantees efficiency in the provision of local public goods in the same way the competition among firms assures efficiency in the market for private goods. Consequently, interjurisdictional or regulatory competition is premised on the perception that a variety of goods and tax levels will better satisfy heterogeneous preferences of citizens.[26]

The theory of interjurisdictional competition has been criticised for its narrow set of assumptions that may not be found in reality.[27] Most importantly, the assumption on the high mobility of citizens is not supported by empirical evidence (Eichenberger, 1994). Other types of regulatory competition have been distinguished that rely on mobility of other factors than persons, firms and capital. So-called 'yardstick competition' emphasises mobility of information as a reason for local governments' higher responsiveness to citizens' preferences. Whereas Tiebout's interjurisdictional competition relies on what Albert Hirschman referred

[26] On interjurisdictional competition see further (Kenyon, 1997).
[27] See for instance Van den Bergh (1994, 1996, 2000).

to as the 'exit' mechanism as the means by which citizens can influence government policy, 'yardstick competition' emphasises Hirschman's 'voice' mechanism (Hirschman, 1970). In this theory, citizens of a jurisdiction use information about the policies implemented in other jurisdictions to evaluate the performance of their own government. This process increases electoral competition and thereby pressures the government to act in the citizens' benefit (Breton, 1991, 40).[28] Other theories of regulatory competition focus on competition through choice of law[29] or through international trade.[30]

However, even in the presence of competitive pressure, politicians may not have incentives to improve regulations, or despite the right intentions fail to perform any better than the private market. According to Sinn's 'selection principle', governments take up those tasks that cannot be successfully managed by the market: the areas where market failures exist (Sinn, 1997). Competition between governments for performing these tasks may bring back the very market failures that government intervention was meant to solve. Hence, regulatory competition may not yield beneficial outcomes for precisely the tasks that should be performed by the government in the first place.[31]

In the last three decades a broad theoretical and empirical literature emerged on the merits and problems of regulatory competition.[32] The main arguments in favour of regulatory competition are that it would lead to more efficient legal rules that better reflect citizens' preferences and to more innovative policies and faster adaptation of legal rules to new problems and circumstances (Kerber, 2009). Proponents of this idea of regulatory competition as a 'race to the top' highlight the example of firms choosing corporate law in the United States, with Delaware as the most successful state to attract firms with its corporate law. Critics of regulatory competition emphasise that it can lead to the circumvention of mandatory

[28] On yardstick competition see also Salmon (2005).
[29] See e.g. O'Hara (2002).
[30] See further Hirschman (2003); Kerber and Budzinski (2003).
[31] See also Sinn (2004).
[32] See Koop and Siebert (1993); Sun and Pelkmans (1995); Ogus (1999); Van den Bergh (2000); Heine and Kerber (2002); Trachtman (2000); Oates and Schwab (1988).

regulations, high information costs and, most prominently, a competition for low regulatory standards rather than the best standards. In this view, regulatory competition produces a 'race to the bottom' rather than a 'race to the top'. In environmental law, for example, a higher standard may lead firms to move away, since it raises their costs. A regulator may therefore have an incentive to relax its standards, which in turn may lead regulators in other jurisdictions to lower their standards as well. Some commentators are also not optimistic about a 'race to the top' in corporate law.[33]

The only aspects that the two camps have in common, is that they assume that law can be seen as a product (Romano, 1985), and that allowing for choice of law will result in regulatory competition. However, the empirical evidence for the existence of regulatory competition is mixed. A recent study into regulatory competition in the European corporate debt market finds that the withholding tax rate may be a driver of the location choices of debt issuers, but finds no empirical support for an influence of the creditor protection rules (Eidenmüller et al., 2015). Another study, in the field of regulatory competition in European company law, does not find empirical evidence to support the claim that changes in the German company law stopped German firms from choosing the English company law instead (Ringe, 2013). In the context of contract law, Vogenauer (2013) finds no empirical evidence that meaningful regulatory competition exists in reality. Vogenauer finds that while legal systems may 'compete' for parties choosing their contract laws and litigating in their courts, this competition does not qualify as regulatory competition, which also requires that customers exercise their choices based on the quality of the different legal rules that are available to them, and that lawmakers improve the quality of their legal rules in order to make their regimes more attractive.

It appears that the likelihood and outcome of regulatory competition may vary depending on the particular policy area. In some fields it is doubtful that regulatory competition will emerge at all, since the regulations are not of much interest to citizens and firms, and consequently do not affect legislators (Geradin, 2003). A

[33] See, for instance, Bebchuk (1992).

'race to the bottom' has been argued to be less likely for areas of 'facilitative law' than in 'interventionist' law. The reason is that interventionist law tends to involve both winners and losers, because some will benefit from the legal protection whereas others will be subjected to obligations.[34] Contract law has been named as an area where regulatory competition could be beneficial (Wagner, 2002). The potential for regulatory competition may even depend on the type of legal rules, which may vary within legal fields (Kerber, 2009). Consider for instance consumer law, which is particularly complex since firms, consumers, and products may cross national borders. On the one hand, destructive competition could arise as regulators may have incentives to compete for domestic producers rather than consumer protection, leading to a too low level of consumer protection (Kerber, 2000). On the other, any regulatory competition might be beneficial by mitigating inefficiencies that harmonised regulation may cause, such as restrictions on market entry and impediments to product innovation (Van den Bergh, 1994). In sum, it is difficult to draw general conclusions as regards the potential for and outcomes of regulatory competition (Van den Bergh, 2016). The criteria for beneficial regulatory competition need to be studied for a specific legal context.

2.2.3 Political economy

In reality, governments may not be as perfect as is assumed in Oates' model. Geoffrey Brennan and James Buchanan first developed the Leviathan model of government, in their 1980 book *The Power to Tax*. They assume that the government acts as a monopolist that maximises tax revenues, requiring citizens to impose constraints on the government that limit its ability to raise taxes to a given amount (Brennan and Buchanan, 1980). When allowing for political economy considerations, it is more difficult to draw straightforward normative conclusions on the appropriate degree of centralisation (Persson et al., 1996, 3). Nevertheless, generally it is thought that Leviathan behaviour may be better constrained un-

[34] Ogus (1999) distinguishes in this context homogeneous legal products, for which market actors are likely to have similar preferences, and heterogeneous legal products, for which the law creates winners and losers. See also Kerber (2009).

der decentralisation. Decentralisation can enforce the political responsibility of the government and thereby weaken the impact of interest groups and restrain rent-seeking politicians (Brennan and Buchanan, 1980; Breuss and Eller, 2004). Weingast (1995) notes that a government that is strong enough to protect property rights and enforce contracts may also be able to exploit its citizens rather than act in their interest. Therefore, an institutional design must be found that ensures that the government preserves markets, while at the same time allowing it to credibly commit to honouring the limits to its power. Weingast advances the concept of 'market-preserving federalism', arguing that decentralised control over the economy by lower levels of government may limit the degree to which the government can encroach upon the markets. The hypothesis of market-preserving federalism is that because of interjurisdictional competition, which constrains government discretion and tailors the provision of public goods to preferences, federal governance structures outperform centralised states.

Another government failure, besides a government acting as a Leviathan that pursues its own interest, is a government captured by interest groups. A captured government is susceptible to lobbying by interest groups and pursues specifically these interests, rather than the welfare of society as a whole (Pelkmans, 2006b). Decentralisation has been argued to help mitigate the problem of rent-seeking, since it gives the losing groups of rent-seekers an exit option (Kerber, 2000). By contrast, centralisation would make lobbying easier for pressure groups by further distancing it from political accountability and the control of citizens. However, in reality some pressure groups may be more, but others less effective and powerful on a higher regulatory level (Van den Bergh, 1994; Ederveen et al., 2008). If interest groups across jurisdictions have a common interest, they can lobby more effectively together at the central level, whereas if their interests clash they may be more effective on the local level.

2.3 Conclusion

This chapter explained the legal framework for EU harmonisation, as laid down in the principles of conferral, subsidiarity and proportionality. It aimed to verify whether a clear legal yardstick is in place to decide on the division and exercise of EU competences, and how such a yardstick should be designed from an economic perspective.

Other than nation states, the EU only has those competences that have been conferred upon it by its members, the European Member States. Moreover, insofar the EU and the Member States share competences, EU action is delineated by the principles of subsidiarity and proportionality. The principle of subsidiarity is a principle of constitutional design, meant to demarcate the exercise of competences between the EU and its Member States. The balance between centralisation and decentralisation is endemic to any polity in which power is divided between levels of government.

In the EU, the subsidiarity principle requires that the EU only takes action insofar the Member States cannot achieve a particular policy objective on their own, and insofar the EU is better able to achieve it, as defined in Article 5 TEU. This wording has been labelled in the literature as vague, leading to different interpretations on what the subsidiarity principle requires exactly, and to a less than rigorous application of subsidiarity by the EU institutions.

This chapter considered the rationales for subsidiarity, in order to determine how it should be interpreted. Finding that subsidiarity is meant to safeguard against excessive EU power, promote diversity and ensure democratic legitimacy, the chapter concluded that the subsidiarity principle should involve an analysis of the comparative benefits and costs of EU and Member State action. An economic approach to subsidiarity was promoted, viewing it as a functional principle that can inform policy makers and underpin the (ultimately political) decision on harmonisation. In order to ensure that subsidiarity can impose an enforceable limit upon the right of the EU to exercise its power in areas of shared competence, these comparative costs and benefits need to be clarified.

The final part of this chapter discussed these considerations involved in an economic test of subsidiarity as elaborated in the literature on the economics of federalism. Decentralisation of tasks should be the starting point, since this ensures best that policies reflect local preferences, and allows for regulatory experimentation and competition for the best rules. Centralisation may be preferable if decentralised policy making leads to suboptimal outcomes, due to for example externalities, or possibilities for scale economies or transaction cost savings. Other arguments for centralisations exist if regulatory competition leads to a race to the bottom, and depending on the influence of interest groups.

These economic considerations form the basis for the analysis in the subsequent chapters of this thesis. The next chapter considers the legal and economic considerations for harmonisation in the specific context of the legislative competence for the internal market.

Chapter 3

Integration and Trade: How Much Harmonisation For the Internal Market?

The previous chapter presented the legal and economic literature relevant for harmonisation of rules in the EU. This literature forms the basis for the broader framework developed in the current and subsequent chapters. This chapter focuses specifically on harmonisation aimed at improving the internal market. The chapter builds upon the existing legal and economic literature, in order to develop a Law and Economics framework for harmonisation to improve the internal market. It examines the relation between and the shortcomings of two economic theories of harmonisation, and evaluates the legal limits to harmonisation for the internal market in light of the economic arguments.

3.1 Introduction

At the outset, the European project was meant to be a project of economic integration. Pooling the production of coal and steel was seen as a common foundation

for economic development that would ensure that any war in Europe would become 'not merely unthinkable, but materially impossible', as worded in the 1950 Schuman Declaration.[1] Establishing a common market for coal and steel formed the basis for broader economic integration, by building a general European single market. Economic integration required taking down barriers - negative integration - as well as harmonising rules - positive integration.[2] Economic integration was initially embraced as a virtuous process. However, whereas negative integration is now seen as rather uncontroversial, the policies of increasing harmonisation of rules have been viewed much more critically (Kerber, 2016). This criticism increased as harmonisation functionally expanded, taking it ever deeper into areas which may seem remote from building a single market (Weatherill, 2004b). The EU legislator maintains that further harmonisation and centralisation of regulatory powers is necessary to improve and complete the internal market. Nevertheless, much of today's dissatisfaction with the EU boils down to a concern that the original mission of economic integration has turned into a misguided push for a political union.[3] This chapter addresses the question of the limits to the harmonisation of rules for the purpose of completing the internal market, considering it from both an economic and a legal perspective.

Following the logic of the economic concept of market integration, there seem to be no boundaries to the range of discriminatory barriers that should be removed under the realm of completing the internal market. If complete economic integration is considered to be the goal, any difference in law, but also language, culture, taste or habit can be considered an obstacle. Conversely, the economic theory of federalism discussed in chapter 2 takes a very different starting point: it relies on the basic premise that heterogeneous preferences should be accounted for in determining the optimal level of legal harmonisation. Following this approach, uniform rules are by no means always the optimal solution. This raises the question of how integration economics and the economics of federalism can be

1 European Union, 'Declaration of 9 May 1950'.

2 On negative and positive integration see further Section 3.4 below.

3 The Economist, 'Economic integration and the 'four freedoms", 10 December 2016, available at `http://www.economist.com`.

reconciled. As will be seen in this chapter, an overarching, integrated theory is still missing. Such a theory would have to incorporate the internal market in the logic of the economics of federalism, or, conversely, include the value of different preferences in the economics of integration.

From the legal perspective, too, there appear to be few limits to the possibilities to harmonise rules for the benefit of the internal market. The legislative competence of Article 114 TFEU is notoriously broad (Weatherill, 2004b), potentially affecting any law that forms an obstacle to the four freedoms or that distorts competition in the single market. This raises the question of the limits on the legislative competence of Article 114 TFEU. This chapter discusses how the use of this competence has been curtailed by the European Court, and how it may be limited by the legal requirements for European harmonisation enshrined in the principles of conferral, subsidiarity and proportionality discussed in chapter 2.

This involves the question of how much room is left for a subsidiarity test in proposals based on the legislative competence of Article 114 TFEU. The recent European initiatives discussed in the introductory chapter take as a starting point that variation in rules between the Member States forms an obstacle to the functioning of the internal market. This obstacle of legal fragmentation forms the basis for harmonisation, which is meant to ensure a level-playing field or to increase cross-border trade. Following this logic, it can be asked whether it is still possible for the subsidiarity test to be answered in favour of decentralisation. Subsidiarity requires that harmonisation only takes place when the objective cannot sufficiently be achieved by the Member States on their own, and can be better achieved by the EU. It is evident that when the objective of ensuring the functioning of the internal market is equated with the need for uniform rules, one easily reaches the conclusion that this objective cannot be achieved by the Member States and harmonisation is justified.

The remainder of the chapter is organised as follows. Section 3.2 provides a historic overview of the development of the internal market in the European Union. Section 3.3 discusses the legal limits to harmonisation aimed at improving the

internal market: the limits to Article 114 TFEU as determined by the Court, and the limits offered by the principles of subsidiarity and proportionality. Section 3.4 summarises the economic theory of integration and presents an analysis of the relation between harmonisation and trade. This section also considers how the economics of integration can be reconciled with the economic theory of federalism. The concluding section, 3.5, discusses why a perspective beyond trade, and including local preferences, is more appropriate for determining whether further harmonisation is desirable to improve the internal market, offering a stepping stone for the next chapter.

3.2 The evolution of the internal market

The creation of the internal market was the primary objective for European integration at the start of the European project. The first step towards European integration was the establishment of the European Coal and Steel Community (ECSC) in 1951. The countries to the Treaty of Paris - France, West Germany, Italy, Belgium, Luxembourg and the Netherlands - created a common market for coal and steel by eliminating the restrictions against the free movement of products and people employed in the coal and steel industry.[4] The goal of the ECSC was to contribute to economic expansion, developing employment and improving the standard of living in the participating countries. The idea was that the common market for coal and steel would assure the most rational distribution of production at the highest possible level of productivity (Article 2 ECSC Treaty).

The next step was made in the Spaak Report in 1956,[5] which provided the basis for the treaty negotiations that led to the signing of the Treaty Establishing the European Economic Community (EEC Treaty) in 1957. The Spaak Report proposed creating a single market in Western Europe, which included eliminating protective barriers to ensure fair competition, reducing state intervention and

[4] Treaty establishing the European Coal and Steel Community (ECSC Treaty).

[5] Rapport des chefs de délegation aux Ministres des affaires étrangères concernant l'unification de l'Europe dans le domaine économique, Brussels 21 April 1956.

establishing common competition rules. The EEC Treaty was essentially a response to the failure of a more ambitious attempt to integrate Europe (Barnard and Peers, 2014, 307).[6] The 1952 treaties for the European Defence Community and the European Political Community had not survived the national ratification process in France. The common market was seen as a vehicle to move integration forward in a more modest way.

Establishing a common market required abolishing customs duties, quantitative restrictions and other obstacles to the freedom of movement for goods, services, persons and capital, as well as establishing a common customs tariff. At the same time, a common market required a common trade policy and competition policy in order to function properly, as well as common agricultural and transport policies. The Treaty thus foresaw not only the removal of barriers but also positive integration, that is, the approximation of national laws by the European institutions. This was made possible by Article 100 EEC, which empowered the Council to pass legislation to harmonise national laws to the extent necessary for the functioning of the common market. An additional vehicle for harmonisation was enshrined in Article 235, which permitted the Council to take measures for the functioning of the common market in cases where the Treaty had not provided the necessary powers. Nevertheless, initially the primary means of attaining market integration was negative integration, meaning the prohibition of Member States' rules that formed barriers to the free movement of goods, persons, services and capital. This was achieved through Article 30, which prohibited quantitative restrictions on imports and all measures having equivalent effects.

At the time, economists seemed to have little appreciation for the enormous potential significance of these provisions (Pelkmans, 2008). Neither were lawyers particularly concerned about the limits of the EU's powers (Barnard and Peers, 2014, 318). The consequences were also not yet visible, with each of these provisions for the removal of barriers and the harmonisation of laws facing its own problems. Article 100 EEC required unanimity in the Council, which proved an insurmountable obstacle to progress in this area. Unanimity was also required in

[6] See also Dinan (2004), chapter 2.

Article 235, which was hardly used as a legal basis until the 1970s. Many attempts during the 1960s and 1970s of the Commission to harmonise Member States' rules to establish the single market were unsuccessful because not all Member States agreed (Egan, 2010, 262). Member States proved to be reluctant to sacrifice domestic interests for the common good (Scott, 1999). Insofar as approximation of rules took place, it was very partial and it primarily concerned goods markets (Pelkmans, 2008). The free movements of goods and services in Article 30 faced its own problems, as it was limited by the exceptions laid down in Article 36. These exceptions offered Member States leeway to erect impediments to trade where national concerns of public morality, policy, safety or security were at stake. Member States eagerly made use of this possibility to adopt protective measures, as a result of which integration stagnated. Integration even regressed, with much of the earlier integration in terms of coordinating Member States' policies, being undone (Popa, 2011, 235). The number of cases brought before the Court regarding the free movement of goods increased significantly (Young, 2010, 110).

An important step for the removal of non-tariff barriers was the *Cassis de Dijon* judgement of the Court in 1979, in which it introduced the principle of mutual recognition in regard to national regulations.[7] The *Cassis de Dijon* judgement concerned a national rule fixing the minimum alcohol percentage for alcoholic beverages. The Court considered that this rule was equivalent to a quantitative restriction to the free movement of goods, and prohibited it. This case created the foundation for the mutual recognition principle, which prohibits Member States from banning goods and services from sale on their territory when these products have been lawfully produced in any other European Member State. Member States have to accept these products even if they are produced to technical or quality specifications different from those applied to their domestic products. The only permitted exceptions are reasons of overriding general interests such as health, consumer or environmental protection, and these exceptions are subject to strict conditions. *Cassis de Dijon* thus limited the regulatory powers of the

[7] Case C-120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung fúr Branntwein* [1979] ECR 649.

Member States considerably. In later cases the principle of mutual recognition was extended to all four fundamental freedoms.

During the 1970s and 1980s, many EEC Member States faced large trade deficits, high inflation and unemployment, and an overall poor competitiveness on the global scale. The period was marked by political stagnation of European integration as well, also referred to as Euro-sclerosis. Enlargement progressed at a slow pace, democracy was perceived to be weak at the European level, and the common market had failed to materialise as had been envisaged (Barnard, 2013, 10). Nevertheless, ultimately the awareness among Member States that their economic interdependence required a coordinated response contributed to a renewed support for further European integration (Young, 2010, 111; Egan, 2010, 264-5). Positive integration emerged, mostly in the form of minimum standards that left Member States room to set their own standards, which were subject to the principle of mutual recognition (Young, 2010, 112-3).

A major development, that can be said to have brought the period of Euro-sclerosis to an end, was the ambitious plan for a single market presented by Jacques Delors, the president of the European Commission at the time. A White Paper titled *Completing the Internal Market* was prepared that identified the barriers to the four fundamental freedoms and proposed a list of approximately 300 measures to be undertaken to remove these barriers.[8] These proposals included measures to remove trade barriers as well as to set common standards, thus comprising both negative and positive integration. The proposal was part of the so-called '1992 programme', also referred to as the 'new approach to the single market'. The program was welcomed by the European Council in Milan, which called for a draft Treaty covering this strategy of deeper economic integration and political cooperation. This was finalised as the Single European Act (SEA) in 1986.

The SEA brought major changes that fuelled the possibilities for harmonisation of rules, both in new areas such as monetary policy, as well as by amending the legislative procedures. Most importantly, the SEA replaced unanimity with qual-

[8] Completing the Internal Market: White Paper from the Commission to the European Council, Milan, 28-29 June 1985, COM/85/0310 final.

ified majority voting in the Council for harmonisation measures based on the internal market (Article 14 SEA, currently Article 114 TFEU). Such measures could now be adopted without the support of all the Member States, whereas previously, unanimity ensured that only those measures could pass that all Member States supported. While prior to the SEA the limitations of EU competences had seemed an insignificant issue, the abolition of vetoes meant that Member States could no longer exercise complete control over further harmonisation. This suddenly awarded the limits of the competences of the EU much more importance (Barnard and Peers, 2014, 318; Weiler, 1999, 39-74). By changing the Community decision-making process, the SEA not only succeeded in removing the technical barriers to trade, but also had spillover effects on many common policies, such as transport, taxation and environmental protection (Moussis, 2015, 117). The SEA moreover enhanced the power of the European Parliament, by introducing the co-operation procedure on policies aimed at establishing or improving the single market (Article 18 SEA). This decision power of the European Parliament represented an extra hurdle in adopting single market policies, but is also believed to have made these policies more legitimate (Young, 2010, 199). Finally, the SEA defined the single market as 'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured' (Article 13 SEA), emphasising that frontiers which fragmented the single market did not just consist of custom duties, but also of fiscal and regulatory frontiers (Popa, 2011, 237; Pelkmans, 2008, 34).

The SEA set a deadline for the completion of the internal market: 31 December 1992. In this year the Treaty on European Union (or: Treaty of Maastricht) was signed, which introduced further innovations such as the co-decision procedure that awarded the European Parliament the role of co-legislator next to the Council. It also laid the foundations for the Economic and Monetary Union (EMU), which represented the next stage of the European integration process. The single market, however, had not been completed yet. In 1997, the Commission issued an Action Plan outlining the main priorities for improving the functioning of the internal

market by 1999.[9] In this year the Commission also launched the Single Market Scoreboard, which offered an overview of the current state of the single market and gauged whether Member States were meeting the targets laid down in the Action Plan. Today, a yearly Single Market Scoreboard still monitors the Member States' efforts to implement internal market policies and offers information on these policies to businesses and citizens.

In 1999 the 'Strategy for Europe's Internal Market' followed, which provided strategic objectives to be achieved in a five-year period. These objectives were updated in the subsequent years and revolved around increasing Europe's competitiveness, improving the quality of life of citizens, and improving the business environment.[10] In 2007 the Commission launched a new approach in light of the accession of new EU countries.[11] Regarding the completion of the internal market, the focus shifted away from removing cross-border barriers towards more effective implementation, consultation of stakeholders and simplification of legislation (Popa, 2011, 239).

The 2009 Treaty of Lisbon only brought modest changes as regards the internal market. The Treaty now explicitly states that the competence for the internal market is a shared competence, meaning that the principles of subsidiarity and proportionality are relevant.[12] The Treaty also allowed for measures relating to the internal market to be taken under the ordinary legislative procedure.[13]

[9] Action Plan for the Single Market, Communication of the Commission to the European Council, CSE(97)1 final, 4 June 1997.

[10] The strategy for Europe's internal market. Communication from the Commission to the European Parliament and the Council, COM (99) 624 final, 24 November 1999, COM (99) 624 final/2, 29 November 1999.

[11] European Commission, Communication 'A single market for 21st century Europe', 20 November 2007, COM (2007) 724.

[12] These principles concern the division between the EU legislator and the Member States of the exercise of a competence, and do not apply in the context of exclusive competences of the Union. See chapter 2, section 2.1.1 above.

[13] The ordinary legislative procedure is the standard decision-making procedure used in the European Union. It applies unless the treaties specifically state one of the special legislative procedures for the particular subject. Before the Treaty of Lisbon came into force, this procedure was referred to as the co-decision procedure. The procedure entails that both the Council of Ministers and the European Parliament have a deciding vote in the legislative

Since the Lisbon Treaty came into force, the internal market has returned to the EU political agenda, with several initiatives being taken by the Commission such as the 2010 Monti report on how to relaunch the single market.[14] The Monti report identified three main challenges for the single market: i) the erosion of the political and social support for market integration in Europe; ii) a lack of attention for newly developed markets; and iii) a lack of political priority due to the belief that the single market has been completed. In October 2010 the Commission responded with the Communication 'Towards a Single Market Act', in which it proposed 50 measures for improving the single market.[15] The latest initiative is the 2015 new Single Market Strategy, which aims to deliver 'a deeper and fairer Single Market that will benefit both consumers and businesses'.[16]

Completing the European internal market thus remains an ongoing process. In his mission letter accompanying the Monti report, Commission President José Manuel Barroso stated that in times of economic crisis there remains a strong temptation to roll back the single market and return to economic nationalism, and that the full potential of the single market has not yet been delivered. He noted that 'there are missing links which prevent a still fragmented market from acting as a powerful engine for growth and delivering the full benefits to consumers'.[17] The Monti report advocated more integration, in more areas, and called upon the Council to push this forward.[18] This illustrates that the end of harmonisation to complete the internal market does not appear to be in sight. Nevertheless, one may wonder at what point one could consider the internal market as complete, and, if such a

process, and may amend a proposal.

14 A New Strategy for the Single Market: At the Service of Europe's Economy and Society. Report to the President of the European Commission José Manuel Barroso by Mario Monti, 9 May 2010 (Monti report).

15 Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions, Towards a Single Market Act, COM(2010) 608 final.

16 European Commission, Upgrading the Single Market: more opportunities for people and business, COM(2015) 550 final.

17 Mission letter from the President of the European Commission, included in the Monti report, pp. 3-4.

18 Monti report, pp. 105-6.

point could already be determined, whether a complete internal market is also a desirable goal to pursue.

The next sections consider these questions from a legal and an economic perspective, exploring the existing constitutional and judicial limits to harmonisation for the internal market, as well as the optimal constraints from an economic perspective.

3.3 The limits of internal market harmonisation

3.3.1 The reach of Article 114 TFEU

Given the economic nature of the Treaty of Rome, it is perhaps not surprising that significant effects upon Member States' culture were initially not expected. In reality, however, the internal market provisions turned out to reach far beyond trade legislation, interfering in various aspects of people's daily lives. Twenty five years ago, Advocate General Jacobs noted that deployment of the internal market's legal basis for harmonisation 'generally leads to Community legislation touching the most diverse areas of national law'.[19] This appears to be ever more true today, with matters of consumer contract law, civil procedural law and other aspects of private law being harmonised in the realm of the internal market.

Today, Article 114 TFEU enables the European institutions to 'adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.' Article 26(2) TFEU states that 'the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured'. The paramount question is how far the power to legislate reaches, since almost everything has some kind of impact on the internal market (Barnard and Peers, 2014, 316).

[19] Opinion of Advocate General Jacobs in Case C-350/92 *Spain v Council* [1995] ECR I-1985, para. 26.

The difficulty with Article 114 TFEU as a legal basis to act is that it is not limited in terms of subject matter. The provision is a functional competence, allowing European lawmakers to adopt harmonisation measures in any field and regarding any issue, as long as such measures are intended to further the establishment and the functioning of the single European market (Rühl, 2015). Article 114(2) TFEU only excludes harmonisation of fiscal provisions, provisions relating to free movement of persons, and rules relating to the rights and interests of employed persons. The functional character of Article 114 TFEU makes it a flexible legislative competence, offering the legislature a great deal of discretion in deciding which subjects it will harmonise (Ramalho, 2014). The legislature is also relatively free to choose the instrument it deems appropriate in a given situation (Lohse, 2011). The nature of the instrument may have an impact on the harmonising effect of its content. Directives, for example, may have a higher harmonising effect than non-binding measures that leave the Member States regulatory freedom (Ramalho, 2014).

The reach of Article 114 TFEU was confronted in the case of *Tobacco Advertising*.[20] In this judgement the Court for the first time annulled a Directive for going beyond the competence attributed to the European legislature in the Treaty. The case concerned Directive 98/43, which was adopted pursuant to the internal market's legal basis and aimed to open up the market for advertisement of tobacco products. The Commission argued that disparities between national laws on the advertising of tobacco products led to obstacles to the free movement of goods and services, and chose to ban all advertising of tobacco products to ensure the free movement of press products.[21] Germany opposed the measure in the Council but was outvoted. Having lost the political battle, Germany turned to the Court and challenged the validity of the Directive on a number of grounds.

[20] Case C-376/98 *Germany v European Parliament and Council* [2000] ECR I-8419 ('*Tobacco Advertising*'). At the time of the judgement, the internal market's legal basis was laid down in Article 95 EC, and before that in Article 100a EC Treaty.

[21] European Parliament and Council Directive 98/43/EC on the approximation of the laws, regulations and administrative provisions of the Member States relating to the advertising and sponsorship of tobacco products (OF [1998] L213/9).

Among other things, Germany argued that, in reality, the Directive was not an internal market measure but a health protection one, for which the Treaty explicitly excluded harmonisation. The Court acknowledged that the ban on harmonisation in the field of health protection should not be circumvented, but nevertheless found that internal market measures may have effects on other concerns. The Court took a very wide approach to the concept of the functional competence of Article 114 TFEU, allowing harmonisation not only for policies on various subject matters, but also with various policy goals. This broad notion of the internal market-goal was confirmed in later cases. In the case *Ex parte BAT*, the Court held that if legislation pursues two 'indissociably linked' aims, neither 'being secondary or indirect in relation to the other', then the legislative act in question may, exceptionally, be founded on the various corresponding legal bases.[22] While the term 'exceptionally' seems restrictive, the Court later indicated that the European legislature cannot be prohibited from relying on Article 114 TFEU as a legal basis on the grounds that another interest is 'a decisive factor in the choices to be made'.[23] This effectively leaves the Commission considerable room to adopt measures on the internal market legal basis, even if other policy goals are at stake.

Nevertheless, the Court rejected the notion that Article 114 TFEU would give the EU legislature *carte blanche* to harmonise laws (Weatherill, 2004a, 13). Such a finding would be incompatible with the principle of conferred powers enshrined in Article 5 TEU.[24] The Court clarified that Article 114 TFEU does not provide a general power to harmonise, but rather gives two specific competences. The first is the competence to establish the internal market, thereby eliminating obstacles to free movement. The second is the competence to improve the functioning of the internal market, thereby eliminating distortions of competition. For a measure to

[22] Case C-491/01 *The Queen v Secretary of State for Health, ex parte British American Tobacco (Inv) Ltd and Imperial Tobacco Ltd* [2002] ECR I-11453 ('*Ex parte BAT*'), paras. 93-94. See also C-281/01 *Commission v Council (Energy Star Agreement)* [2002] ECR I-12049, paras. 33-35.

[23] Case C-58/08 R *Vodafone and Others v Secretary of State for Business, Enterprise and Regulatory Reform* [2010] ECR I-4999, para. 36.

[24] According to this principle, the European Union only has those competences that have been conferred upon it. See further section 2.1.1 in chapter 2.

be valid under Article 114 TFEU, it must genuinely seek to establish the internal market or to improve its functioning.[25] The internal market is a genuine goal if the measure is designed to prevent obstacles to free movement which exist or are likely to occur, or if it overcomes appreciable distortions of competition.

The breadth of the competence to harmonise for the first goal, the establishment of the internal market, depends on the reading of the concept of an 'obstacle' to one of the four freedoms. In *Tobacco Advertising*, the Court emphasised that a 'mere finding of disparities between national rules and of the abstract risk of obstacles to the exercise of fundamental freedoms' is insufficient to justify recourse to Article 114 TFEU.[26] If the mere finding of disparities between national rules or the abstract risk of obstacles to the fundamental freedoms were sufficient to justify harmonisation under Article 114 TFEU, the powers of the EU legislature 'would be practically unlimited'.[27] Such an approach would leave the principle of conferral devoid of meaning in practice (Rühl, 2015, 436). The EU legislature may have recourse to Article 114 TFEU 'where there are differences between national rules which are such as to obstruct the fundamental freedoms and thus have a direct effect on the functioning of the internal market', or 'if the aim is to prevent the emergence of such obstacles to trade resulting from the divergent development of national laws'.[28]

The question remains what the precise conditions are for an 'obstacle' to the freedom of movement. An 'obstacle' does not necessarily have to be an existing barrier but could include future obstacles to trade that could arise if national laws developed in different directions. However, if future obstacles are targeted, their emergence must be likely and the measure in question must be designed to prevent them.[29] In practice, it may however be difficult to determine whether the

[25] See also *Ex parte BAT*, footnote 22, para. 60.

[26] *Tobacco Advertising*, footnote 20, para. 84. See also Case C-434/02 *Arnold André GmbH & Co. KG v Landrat des Kreises Herford* [2004] ECR I-11825, para. 30, Case C-210/03 *Swedish Match* [2004] ECR I-11893, para. 29, Cases C-154/04 and C-155/04 *Alliance for Natural Health and Others* [2005] ECR I-06451, para. 28.

[27] *Tobacco Advertising*, footnote 20, para. 107.

[28] *Vodafone*, footnote 23, paras. 32-33.

[29] *Tobacco Advertising*, footnote 20, para. 86. Some scholars have argued that harmonisation

emergence of obstacles to free movement is likely (Weatherill, 2011, 833).

Similarly, it is not easy to verify the requirements for the second goal of the internal market competence, to ensure the functioning of the internal market. Harmonisation measures may only be taken based on Article 114 TFEU if distortions to competition are 'appreciable'.[31] Distortions of competition which are minor, or only have remote or indirect effects, are not sufficient to justify harmonisation measures. As the Court put it in *Tobacco Advertising*, '[n]ational laws often differ regarding the conditions under which the activities they regulate may be carried on, and this impacts directly or indirectly on the conditions of competition for the undertakings concerned'.[32] The Court considered that restrictions which offer companies an increase in profits or an advantage in terms of economies of scale have only remote and indirect effects on competition, and do not constitute distortions which could be described as appreciable. Conversely, measures which affect firms' production costs do meet the threshold of appreciable effects on competition. The basis for distinguishing effects on production costs and effects on profits or economies of scale is not very clear. Some have interpreted the Court's ruling as meaning that appreciable distortions of competition only exist where the measure puts individual firms at an immediate and direct disadvantage, and they are not compensated for it (Roth, 2008, 408). However, this does not follow from the Court's wording: effects on production costs could affect multiple firms, whereas effects on profits could concern an individual firm. Consequently, it re-

measures may be taken if legal differences form an obstacle to the fundamental freedoms, while they are not prohibited by Articles 34 and 56 TFEU. These provisions prohibit any quantitative restrictions and measures that have an equivalent effect on the free movement of goods and services, respectively. This interpretation aligns the reach of Article 114 TFEU with the scope of the fundamental freedoms and in particular with the Court's case law on national rules that concern selling arrangements instead of product requirements, particularly Cases C-267/91 and C-268/91 *Keck and Mithouard* [1993] ECR I-06097.[30] This view has been met with sharp criticism, since the scope of Article 114 TFEU should be determined based on its purpose of establishing and enhancing the internal market rather than the judicial interpretation of the fundamental freedoms (Rühl, 2015; Roth, 2008).

[31] Case C-300/89 *Commission of the European Communities v Council of the European Communities, titanium dioxide* [1991] ECR I-02867, para. 23; *Tobacco Advertising*, footnote 20, para. 106.

[32] *Tobacco Advertising*, footnote 20, para. 107.

mains difficult to provide a definition of appreciable distortions of competition (Rühl, 2015, 439).

Nevertheless, from *Tobacco Advertising* and subsequent cases a number of conditions can be distilled for harmonisation under Article 114 TFEU:

(i) The measure must genuinely aim to improve the conditions for the establishment and functioning of the internal market, meaning that the measure aims to eliminate:

  (a) an appreciable distortion of competition, or

  (b) an obstacle to the fundamental freedoms

(ii) The differences between national rules must directly affect the functioning of the internal market;

(iii) If the emergence of future obstacles to trade is being prevented, it must be likely that such obstacles would emerge in the absence of harmonisation.

Whereas *Tobacco Advertising* highlighted that Article 114 TFEU has limits, subsequent cases before the European Courts clarified that these limits are still very wide. In *Swedish Match* the Court accepted that banning a product could contribute to the functioning of the internal market, arguing that national rules developing in different directions was creating obstacles to trade.[33] In *Tobacco Advertising II*, the Court held that Article 114 TFEU can be relied upon when differences between national rules exist which 'obstruct the fundamental freedoms and thus have a direct effect on the functioning of the internal market'.[34] While the *Tobacco Advertising* judgement may have been an indication towards a more constitutionally contested process of harmonisation, it now seems to have been an anomaly (Weatherill, 2004b, 646; Weatherill, 2011, 843). In hindsight, *Tobacco*

[33] *Swedish Match*, footnote 26.

[34] Case C-380/03 *Germany v Parliament and Council* [2006] ECR I-11573 ('*Tobacco Advertising II*'), para. 37. See also *Alliance for Natural Health and Others*, footnote 26, para. 29; and *Swedish Match*, footnote 26, para. 29.

Advertising can be seen as a response to the introduction of qualified majority voting in the Council for internal market measures, since this had removed the political limits to harmonisation that had existed with unanimity voting. Over time, however, the judicial interpretation of the internal market's legal basis has not appeared to provide a more explicit focus on which harmonisation measures are really needed, and which are not.

3.3.2 Limits provided by subsidiarity and proportionality

As was discussed in chapter 2, the principles of subsidiarity and proportionality aim to put a brake on the exercise of European lawmaking powers, and to ensure that decisions are taken as closely to the citizen as possible. This raises the question of whether these principles can provide a limit to further harmonisation to establish and improve the internal market. Compliance with subsidiarity and proportionality can be reviewed ex ante, by the legislator before policies come into force, or ex post, by the European Courts.

I: Ex ante review

Pursuant to the Protocol on the application of the principles of subsidiarity and proportionality, attached to the Treaty of Lisbon, each legislative proposal issued by the EU legislator needs to explain that it complies with the principles of subsidiarity and proportionality. Moreover, all proposals must be accompanied by an impact assessment which, among other things, considers the compliance of the proposal with these principles. However, in actual practice it is notorious that EU legislative proposals merely assert compliance with the subsidiarity principle, rather than demonstrating it (Weatherill, 2011, 844). The passages dealing with subsidiarity in impact assessments and explanatory memoranda of the Commission often simply state that the requirements of subsidiarity are complied with (Wyatt, 2003, 90).

For example, the 2000 Directive on electronic commerce notes that 'by dealing

only with certain specific matters which give rise to problems for the internal market, this Directive is fully consistent with the need to respect the principle of subsidiarity as set out in Article 5 of the Treaty'.[35] Similar wordings can also be found in more recent proposals, such as the 2011 Consumer Rights Directive.[36] The Consumer Rights Directive introduces full harmonisation in several areas of consumer protection that were previously governed by EU minimum standards, and hence represents deeper European integration in this field. Member states will no longer be allowed to deviate from the EU standards by imposing stricter standards, as they were before. The Directive lays down requirements on information to be provided by traders in consumer contracts, regulates the right of withdrawal and provides rules on delivery and passing of risk. The rules are in many respects stricter than the prior minimum standards, but not always as strict as some of the Member States' national rules that were in place up until now. According to the Commission, full harmonisation is necessary in order to ensure the functioning of the internal market. The Impact Assessment accompanying the Consumer Rights Directive states:[37]

> 'As a result of the **fragmentation** of national consumer laws, a trader wishing to sell cross border into another Member State will have to incur legal and other compliance costs to make sure he is respecting the level of consumer protection of the country of the consumer [...]. This is a **regulatory barrier to the completion of the internal market**.
>
> This problem cannot be solved by the Member States individually since it is the very **uncoordinated usage of the minimum harmonisation clauses** by the Member States that is **at the root of the problem**. Likewise, addressing new market developments, regulatory gaps and inconsistencies in EU consumer laws in an uncoordinated manner generates more fragmentation and exacerbates the problem.

[35] Directive 2000.31.EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (Directive on electronic commerce), Preamble, recital 6.

[36] Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council Text with EEA relevance, OJ L 304.

[37] Impact Assessment, pp. 14-15.

> Only a coordinated EU intervention can contribute to the completion of the internal market by solving this problem.'

The Directive itself remarks that 'The harmonisation of certain aspects of consumer distance and off-premises contracts is necessary for the promotion of a real consumer internal market striking the right balance between a high level of consumer protection and the competitiveness of enterprises, while ensuring respect for the principle of subsidiarity'.[38] The Directive states that the cross-border potential of distance selling is currently not fully exploited, while it should be one of the main tangible results of the internal market.[39] This, it states, is evident from the relatively modest growth in cross-border distance sales as compared to domestic distance sales, particularly for Internet sales. According to the Directive, the cross-border potential of distance and Internet contracts 'is constrained by a number of factors including the different national consumer protection rules imposed on the industry'.[40] Disparities create significant internal market barriers affecting traders and consumers, and increase compliance costs to traders wishing to engage in cross-border sales.[41] Therefore, the Directive notes, the full harmonisation of consumer information and the right of withdrawal will contribute to a high level of consumer protection and a better functioning of the business-to-consumer internal market.[42] Full harmonisation should increase legal certainty for consumers and traders and allow them to rely on a single regulatory framework, so that barriers from the fragmentation of the rules are eliminated and the internal market can be completed. The Directive states that '[t]hose barriers can only be eliminated by establishing uniform rules at Union level'.[43]

This line of argument can also be found in the Impact Assessment accompanying the Proposed Digital Contract Directives, which states:[44]

[38] Directive, Preamble recital 4.
[39] Directive, Preamble recital 5.
[40] Directive, Preamble recital 5.
[41] Directive, Preamble recital 6.
[42] Directive, Preamble recital 5.
[43] Directive, Preamble recital 7.
[44] Commission Impact Assessment Accompanying the Proposals for Directives of the European

> '[t]his initiative complies with the principle of subsidiarity, as Member States on their own initiative would not be able to remove the barriers that exist between national legislation. Each Member State individually would not be able to ensure the overall coherence of its legislation with other Member States' legislation. This is why an initiative at EU level is necessary.'

Essentially, the argument is that i) differences between national consumer laws form a barrier to the completion of the internal market, ii) these differences cannot be removed by Member States themselves, and iii) therefore EU intervention is warranted. The starting point is thus that variation in rules between the Member States in itself forms an obstacle to the functioning of the internal market. This obstacle arising from such legal fragmentation forms the basis for harmonisation, in order to ensure a level-playing field or to increase cross-border trade. The problem of this line of reasoning is that it becomes very unlikely for the subsidiarity test to be answered in favour of decentralisation. Subsidiarity requires that harmonisation only takes place when the objective cannot sufficiently be achieved by the Member States on their own, and can be better achieved by the Union. However, when the objective of ensuring the functioning of the internal market is equated with the need for uniform rules, it is evident that this objective cannot be achieved by the Member States and harmonisation is needed. As Kainer notes, subsidiarity cannot play a major role in the context of internal market harmonisation, because while Member States can achieve particular political goals on their own, they can never achieve the goal of harmonisation better than the EU (Kainer, 2006, 619). Following this logic of legal diversity as an internal market obstacle leaves little room for a subsidiarity test in proposals based on the legislative competence of Article 114 TFEU. As Öberg (2016, 16) puts it, the core of subsidiarity is the right of Member States to diverge, so presuming too easily that the need to prevent divergence justifies Union intervention would turn that principle on its head.

In sum, it appears that ex ante review of compliance with the principles of sub-

Parliament and of the Council (1) on certain aspects concerning contracts for the supply of digital content and (2) on certain aspects concerning contracts for the online and other distance sales of goods SWD/2015/0274 final/2 - 2015/0287 (COD), p. 21.

sidiarity and proportionality does not really bite in practice, to say the least. In the context of internal market measures, it even seems that the policy objectives of EU proposals are being phrased in such a way that compliance with these principles is more or less given from the start. This reduces the justifications for subsidiarity in effect to a statement of the rationale for the legislation itself, instead of a genuine criterion for deciding whether or not to advance the proposal in question (Wyatt, 2003, 90).

II: Ex post review

If ex ante review is not very restrictive, the European Courts could still strike down EU policies for not complying with the principles of subsidiarity and proportionality. The European Court is in principle competent to annul acts for violation of the principles of subsidiarity and proportionality. However, in practice the Court is generally reluctant to do so (Weatherill, 2004a, 15).

In the *Deposit Guarantee Directive* case, Germany unsuccessfully raised the argument that Directive 94/19/EC, the Deposit Guarantee Directive, did not comply with subsidiarity.[45] The Directive imposed a binding guarantee scheme for credit institutions. Germany argued that insufficient reasons were provided in the Directive why such binding rules were necessary, and that the Directive did not indicate why Member States could not achieve its objectives on their own. The Court dismissed Germany's arguments by referring to passages of the Directive in which it read arguments for Union action, although these passages did not explicitly deal with compliance with subsidiarity and proportionality. In the *Tobacco Advertising* case, the Court acknowledged that Germany had invoked the violation of the principle of proportionality as one of the bases for its application for annulment of the Directive, but considered that the obligations in the Directive did not go beyond what was necessary in order to achieve its objective.[46] The Court addressed the compliance with the subsidiarity principle in its 2002 judge-

[45] Case C-223/94 *Germany v. Parliament and Council* [1997] ECR 1-2304 ('*Deposit guarantee Directive*').

[46] *Tobacco Advertising*, footnote 20, paras. 144-160.

ment in *ex parte BAT*. The Court confirmed that the Directive in question was susceptible to review for compliance with subsidiarity, provided it fell in a shared competence of the EU. Regarding the compliance with subsidiarity, the Court took an approach that resembles that of the Commission. The Court ascertained that the Directive's objective is to eliminate the barriers raised by the differences which still exist between the Member States laws. It then concluded that this objective cannot be sufficiently achieved by the Member States individually, and consequently calls for action at Community level.[47]

As was mentioned above, it is difficult to imagine circumstances under which subsidiarity would be violated if it is accepted that harmonisation is necessary to achieve the goal of reducing differences in laws. Weatherill concludes that in *ex parte BAT* the Court neatly sustained subsidiarity as a legal principle on paper while in practice conceding much to legislative discretion. Indeed, in *ex parte BAT*, the Court held that the EU legislator 'must be allowed a broad discretion in an area such as that involved in the present case, which entails political, economic and social choices on its part, and in which it is called upon to undertake complex assessments'.[48] It appears that a measure must be manifestly in breach of subsidiarity or proportionality before the Court will consider it invalid (Weatherill, 2011, 843). Even more so, once it is determined that a competence to harmonise exists, the decision to exercise this competence seems virtually immune from judicial subversion (Weatherill, 2004a, 16). It is worrisome that annulment of a measure on the ground that it violates subsidiarity is likely to occur only in extreme circumstances (Dashwood, 2004, 368; Chalmers et al., 2010, 367). At the same time, the Scottish former President of the Court, Lord Mackenzie Stuart, notes that '[t]o decide whether a given action is more appropriate at Community level, necessary at Community level, effective at Community level is essentially a political topic. It is not the sort of question a Court should be asked to decide.' (European Institute of Public Administration, 1991). Referring to Lord Mackenzie Stuart, Weatherill (2004a, 16) points out that subsidiarity involves political

[47] *Ex parte BAT*, footnote 22, paras. 180-183.
[48] *Ex parte BAT*, footnote 22, para. 123.

judgement about whether to exercise a conferred competence and is evidently treated as less appropriate for judicial control than the prior question of whether a competence is attributed by the Treaty.

In summary, regarding internal market measures the Court has accepted that subsidiarity applies but has in effect held that if there is a competence to adopt the measure, this in itself resolves the question of compliance with subsidiarity. This is comparable to the Commission's approach to subsidiarity: if there is competence to adopt common standards, the adoption of common standards justifies the exercise of the competence (Wyatt, 2003, 91-2). Ex post review of subsidiarity therefore does not appear to limit harmonisation to establish and improve the internal market. Weatherill has stressed that if checking compliance with subsidiarity adds little, it becomes crucial to fix the scope of the competence to act (Weatherill, 2004a, 16). This takes us back to the limits to Article 114 TFEU which, as we have seen, have been interpreted by the Court in a manner that leaves the European legislator considerable discretion.

Consequently, the possibilities for harmonisation for improving the internal market are wide. With a competence to legislate that is not limited in subject matter, and a very lenient approach to the subsidiarity threshold, it is difficult to think of legal policies that could not be harmonised within the realm of the internal market. At the same time, as we have seen in chapter 2, economic theory has provided several reasons why centralisation is not always beneficial, and may in some cases reduce welfare. This bears the question of the economic reasoning behind harmonisation to improve the internal market, as well as the limits on doing so beneficially.

3.4 Economic approaches to integration

3.4.1 Economic theory of integration

The major argument for establishing an internal market by taking down regulatory barriers has been provided by the economic theory of integration. Economic

integration is defined as the elimination of economic frontiers between two or more economies. An economic frontier is any boundary, across of which actual and potential mobility of goods, services and production factors are low. On both sides of an economic frontier, prices and quality of goods, services and factors, are only marginally influenced by the flows over the frontiers (Pelkmans, 2006a, 2).

The economic theory of market integration is based upon the theory of international trade. The objective of opening borders to foster free trade is rooted in David Ricardo's theory of comparative advantage of 1817. Ricardo's analysis demonstrated that even when one of two countries is technologically superior in producing two goods, it could still be advantageous for countries to each specialise in the production of one of these goods, and trade with each other. A comparative advantage is present for those products for which the country has the highest productivity in comparison to other countries, even if this productivity is still lower than in the other country. Ricardo's theory concerns inter-industry trade: the exchange of goods from different industries.

A second type of trade is intra-industry trade, which refers to the exchange of similar products belonging to the same industry. It is this type of trade that is of significance for economic integration, because intra-industry trade can enhance actual or potential market competition. By eliminating economic frontiers, economic integration allows additional market participants from other regions or countries to compete with the local incumbents. A monopolistic market lowers consumer surplus by allowing firms to capture high profits, and creates an efficiency loss to society because not all consumers will be served. Enhanced competition on the market generally lowers consumer prices, ensures a wider choice and greater quality differentiation and pressures incumbent firms to innovate. Hence, economic integration is expected to increase welfare by enhancing competition.

In the theory of economic integration, Tinbergen (1954) distinguished positive and negative integration. Negative integration denotes the removal of trade barriers between the integrating countries by prohibiting discrimination in national economic rules and policies. Positive integration refers to the establishment of

common policies and institutions. As countries become more integrated, further integration generally requires additional positive integration next to negative integration.

In his 1961 book 'The Theory of Economic Integration', Bela Balassa distinguished five stages of increasingly deeper economic integration. The first stage is a **free trade area**, in which custom tariffs and quotas are abolished for goods traded between the members, and members retain their own national tariffs towards third countries. In order to prevent exploitation of differences between the tariffs towards third countries by re-exporting goods, a rules of origin system is needed that certifies the origin of a good. The second stage, a **customs union**, introduces a common external tariff, overcoming the rule of origin-problem. While Balassa views this as a stage with only negative integration, in actual practice, a customs union already needs some degree of positive integration with respect to the common external trade policy and competition policy. The latter is needed to ensure that countries do not favour their own firms. The third stage, a **common market**, adds the free movement of production factors, prohibiting restrictions on the movement of capital, labour and services. Although Balassa still considers this possible without positive integration, in practice a proper functioning of the common market requires harmonisation of regulatory standards to prevent that lower regulators set policies that do not sufficiently take into account external effects on other members (Laffan et al., 2000, 102, Pelkmans, 2006a, 8-9). Free movement of production factors generally improves allocative efficiency and should enhance productivity and economic growth. In the fourth stage, an **economic union**, Balassa sees some degree of harmonisation of national economic policies in order to remove discrimination, although in reality this stage will likely involve considerable harmonisation in various areas. In the final stage of **total economic integration**, in Balassa's view monetary, fiscal, social and counter cyclical policies are harmonised.

There is a large gap between Balassa's concepts of an economic union and total economic integration. In reality, we observe many intermediate solutions in between these two stages. This is exemplified by the EU, which is at a stage in

between an economic union and total economic integration. In the literature various other examples have been named of stages in between the ones distinguished by Balassa, such as a monetary union and a political union, which follow the economic union. Moreover, in practice harmonisation of policies is needed before the final stage of total economic integration. Without further nuance, the Balassa concept does not offer much insight for studying the more advanced stages of integration, in which harmonisation of rules and centralisation of competences play a role (Heine and Kerber, 2003, 108; Kerber, 2016, 3). The theory primarily focuses on the beneficial effect of harmonisation in terms of creating a competitive common market, where goods, services and production factors can move freely.

However, in the EU context of today, where many economic frontiers have already been eliminated, further integration has become more political. Today, taking down more barriers to achieve further market integration generally requires positive integration rather than negative integration, meaning that national policies are being replaced by European ones.[49] While these harmonisation initiatives often still aim to reduce transaction costs related to differences in legal rules, and to enhance competition in the markets, this is no longer the only effect of further integration. The substance of the European policies also represent obligations to some citizens and firms, and benefits to others. This means that a limited focus on the competition-rationale for economic integration may no longer be justified: instead, both the costs of variation in rules and the costs of complying with these rules should be included in an analysis of the effects on competition and trade of further integration. Intra-industry trade models generally focus on the pro-competitive effect of integration in terms of taking down barriers and reducing the costs of selling abroad. The next subsection aims to broaden the view, by including the costs of complying with legal rules into an intra-industry trade model.

[49] For an overview of the empirical literature on the relation between standards and trade, see e.g. Swann (2010). Swann finds support for the widely held view that international standards are (often) supportive of trade, as well as some support for the view that national standards create barriers to trade.

3.4.2 Harmonisation and trade

The model used to study these broader effects of economic integration on trade and competition are illustrated using the Brander-Krugman intra-industry trade model, a model of 'reciprocal dumping' (Brander and Krugman, 1983). In this model, the rivalry of oligopolistic firms serves as an independent source of international trade - aside from comparative advantages, which are not considered - and leads to two-way trade in identical or similar products. Two countries exist, each with one active firm. Initially, if no trade occurs, each firm operates in a monopolistic market. As trade occurs, the markets move towards a duopoly where the firms are in Cournot competition with each other. The oligopolistic rivalry between firms gives rise to 'reciprocal dumping': each firm 'dumps' its products into the other firm's home market at a lower price than the incumbent monopolist.[50] The crucial element for this reciprocal dumping to occur is what Helpman (1982) has referred to as a 'segmented markets' perception: each firm perceives each country as a separate market and determines sales for each market separately. They can therefore discriminate prices between the domestic and the foreign market.[51]

Consider two countries, A and B, with domestic firms A and B respectively. Each firm sells q_{ii} domestically and q_{ij} abroad; $i, j = A, B$. With p_i denoting the price in $i = A, B$, demand can be written as

$$p_i = a - b(q_{ii} + q_{ji}) \tag{3.1}$$

where $a, b > 0$. Whether reciprocal dumping-trade occurs is determined by the costs to the firm of supplying in the foreign country. In the Brander-Krugman

[50] While dumping in general is a controversial issue in trade policy, in this model it can be welfare improving due to its pro-competitive effect.

[51] Once a true single market exists, such an assumption would not be realistic since firms should not be able to discriminate prices across countries. However, here, the starting point is that of a situation before such a complete internal market exists. Empirical evidence suggests that price discrimination is still a reality in Europe, see e.g. Harrison et al. (1996) and Fabiani et al. (2007).

model this cost is formed by transport costs, which make it more costly for the foreign firm to supply the good than for the domestic firm. One can use this model to illustrate the pro-competitive effects of harmonisation of rules, by thinking of the transport costs in terms of transaction costs relating to differences in the applicable rules, and of production costs in terms of costs to comply with the local rules. These rules could be safety standards or consumer protection rules such as mandatory warranties or return periods. Transaction costs in this context can thus be defined as costs to obtain information about the legal system applicable to the transaction, the contents of this system and the differences between the other system and the system of the contracting party (Ott and Schäfer, 2002, 207). In the following, these costs will also be referred to as *costs of legal differences*. By contrast, *compliance costs* concern the costs to fulfil the obligations required by the legal rules.[52]

The transport costs $T > 1$ in the original model are iceberg costs, meaning that a certain fraction of production is 'lost' in trade (Samuelson, 1952). Costs of legal differences thus increase with output, which one could for example interpret in terms of the potential for a consumer protection conflict.[53] The more a firm sells abroad, the higher the probability that a problem arises with an overseas consumer regarding a sale. In each of these cases the firm needs to inform itself about the applicable rules, and potentially get professional legal advice, in order to address the problem.[54]

Production costs c_i can be thought of as costs of complying with the applicable standard, e.g. for consumer protection. Let k_i denote the standard in $i = A, B$, so that compliance costs are $c_i(k_i)$, with $\partial c_i / \partial k_i > 0$. This shape of the cost function

[52] While one could also consider the costs to comply with legal rules as transaction costs, the European Commission appears refer to costs of differences in legal rules when using the term transaction costs. This definition is also used here, but for reasons of clarity these transaction costs will be referred to as costs of legal differences.

[53] A fixed transaction cost would not affect the output choices of the firm at all, and therefore not have an impact on trade.

[54] In this model consumers do not bear any transaction costs of purchasing abroad. Consumers' preferences and shopping behaviour are addressed in chapter 4.

reflects that a stricter standard imposes more obligations on the firm.[55] The profits of a firm then look as follows:[56]

$$\begin{aligned} \pi_{ii} &= [a - b(q_{ii} + q_{ji})]q_{ii} - c_i q_{ii} \\ \pi_{ij} &= [a - b(q_{ij} + q_{jj})]q_{ij} - Tc_j q_{ij} \end{aligned} \tag{3.2}$$

Each firm maximises profit with respect to own output, yielding the following reaction functions and output choices in a given country, for the domestic firm and the foreign firm respectively:

$$\begin{aligned} (a - bq_{ji}) - 2bq_{ii} &= c_i & \qquad q_{ii} &= \tfrac{a+Tc_i-2c_i}{3b} \\ (a - bq_{ii}) - 2bq_{ji} &= Tc_i & \qquad q_{ji} &= \tfrac{a+c_i-2Tc_i}{3b} \end{aligned} \tag{3.3}$$

As long as costs of legal differences exist, i.e. $T > 1$, both firms sell more at home than the foreign firm exports. For any two-way trade to occur, costs of legal differences must be small enough, such that $T < \frac{a+c_i}{2c_i}$. As the costs of legal differences fall, the sales from the foreign firm increase (since $\partial q_{ji}/\partial T < 0$).

Consequently, assuming that harmonising the standards in both countries reduces the firms' costs of legal differences incurred in selling abroad, harmonisation indeed fosters trade and increases competition in the markets of both countries. This, in turn, lowers prices. Prices look as follows if costs of legal differences are sufficiently low for any foreign sales to be made:

$$p_i = \frac{a + (1 + T)c_i}{3} \tag{3.4}$$

Prices decrease as costs of legal differences fall, not only because selling the products is less costly for firms, but also because each firm has to take into account the

[55] Production costs are set at zero. Assuming a positive production cost would not make a difference as long as production costs are assumed to be the same for both firms.

[56] With the second order conditions $\frac{\partial 2\pi_{ii}}{\partial q_{ii}^2} < 0$, $\frac{\partial 2\pi_{ji}}{\partial q_{ji}^2} < 0$, $\frac{\partial 2\pi_{ii}}{\partial q_{ii}\partial q_{ji}} < 0$, $\frac{\partial 2\pi_{ii}}{\partial q_{ji}\partial q_{ii}} < 0$, meaning that profit functions are concave and reaction functions are downward sloping.

actual or potential competition of the other firm in setting its price. In comparison, when costs of legal differences are too high for the foreign firm to profitably sell its products abroad, the domestic firm is a monopolist and set its price accordingly.

However, so far one element has been missing from the story: if harmonising legal standards affects firms' costs of legal differences of selling abroad, also their costs to comply with the standard should be affected. In other words, if firms are concerned with costs of dealing with foreign rules, they can also be expected to care about the content of these rules. For example, it may be more costly for a firm to provide a two-year warranty than a one-year warranty for its product. When considering harmonisation of the legal standard, the resulting uniform standard could take various forms. Assuming that, before harmonisation, the costs are such that $c_i < c_j$, the harmonised standard could be:

- At or below the level of the lowest prior domestic standard ($c_u \leq c_i < c_j$)
- In between the prior domestic standards ($c_i < c_u < c_j$)
- At or above the level of the highest prior domestic standard ($c_i < c_j \leq c_u$)

Consequently, harmonisation can have different effects on the compliance costs of firms across countries. In some countries firms may face higher compliance costs than before, whereas in others the harmonised standard may be cheaper to comply with than before harmonisation. While harmonisation may enhance trade by lowering the costs of legal differences, the effects on compliance costs may have a detrimental effect on trade. Foreign sales drop more than domestic sales due to the effect of costs of legal differences.[57] Nevertheless, this finding results from the underlying assumption in the Brander Krugman model that compliance costs are merely wasteful costs: they represent no benefit to the consumer. In this framework consumers essentially do not care about the standard and will

[57] That is, $\partial q_{ii}/\partial c_i = \frac{T-2}{3b}$ and $\partial q_{ji}/\partial c_i = \frac{1-2T}{3b}$, where the former outweighs the latter because $T > 1$.

choose the cheapest product available. As a result, in this set-up both domestic and foreign sales decrease as compliance costs increase. To study the effect of harmonisation on trade via the compliance costs a richer model is required that takes into account consumer preferences for legal protection (may it be consumer protection or other relevant rules). Such a framework is provided in chapter 4.

For now, let us focus on a related question regarding the relevance of the effect of compliance costs on trade: Why do the standards differ between the countries in the first place? The reasons may vary from different income levels to heterogeneous preferences for legal protection due to historical or cultural reasons. The subsequent question is whether the different preferences for the level of legal protection are worthy of protection, and should be a consideration in the choice of whether to harmonise legal rules. Even if harmonisation enhances trade and competition, may there be reasons for citizens to oppose to having uniform rules in place across countries? These questions expose a weakness of the economic theory of integration: it does not include the impact of heterogeneity in conditions and preferences across countries for the desirable level of integration. Economic theory of integration as discussed above illustrates the beneficial effects of harmonisation on trade and competition, but fails to capture broader welfare effects. Using a pure trade theory perspective, it may be the case that only a limited number of welfare effects can be analysed that are relevant for market integration (Kerber, 2016, 6). Before attempting to integrate welfare effects into a trade model in chapter 4, let us return to the economics of federalism theory discussed in chapter 2 and consider how it compares to economic theory of integration.

3.4.3 Comparing economic theory of integration and the economics of federalism

While theories of economic integration focus on removing barriers to trade and competition in the market, the economics of federalism explores the optimal assignment of competences to different levels of government. The economics of federalism literature addresses the question of when centralisation of public eco-

nomic functions is welfare improving, which also involves the institutional aspects of positive integration. As was discussed in chapter 2, the economics of federalism takes as a starting point that policies should be allocated to the lowest level of government. The reason is that lower government levels are better capable of ensuring that policies correspond to the local preferences of citizens, as compared to the central government. Citizens may have heterogeneous preferences regarding the need for governmental intervention as well as the type of policies, for example because of different cultural, geographical, and economic conditions. In relation to consumer protection, one could think of the specific problems of consumers, the extent of concerns of citizens about safety and health risks, the cultural stance towards governmental intervention and the income level. If countries are heterogeneous in these determinants, uniform regulations are not always the optimal solution from a welfare perspective, since a uniform policy would necessarily be a compromise.

Decentralisation moreover allows for policy experimentation and learning, as well as regulatory competition. Centralisation eliminates the possibility for governments to experiment with different policies, learn from one another, and compete with each other for the best or most attractive set of rules. While a truly integrated market may increase the intensity of regulatory competition, it simultaneously limits the possibilities for states and regions to distinguish their policies to enhance their competitiveness (Kerber, 2016, 7). Accordingly, it is unlikely that meaningful regulatory competition arises in a fully centralised system. Diverse policies across countries, which match the different conditions and preferences in these countries, may therefore lead to higher social welfare than harmonised rules or the centralisation of regulatory powers.

This may be different when cross-border externalities exist, scale economies can be gained or transaction costs can be saved. In such cases, centralised policy-making may increase welfare. The same holds if a system of regulatory competition results in a race for laxity, with standards below the socially optimal level. Consequently, determining whether harmonisation of a certain policy area is desirable involves a balancing act of the advantages of decentralisation and those of centralisation.

There are limits to the desirability of further integration for economic welfare, despite the potential beneficial effects of further integration on trade and competition in the market.

This seems difficult to reconcile with the logic of integration economics, which does not offer normative insights on the optimal level of integration beyond the notion that further integration of the market is beneficial. As Pelkmans puts it, the economic definition of market integration offers a simple benchmark, but a benchmark that cannot distinguish desirable from undesirable integration. It inevitably suggests that moving closer to the benchmark is 'good', a notion that conflicts with the justified aspects of diversity in rules and regulations (Pelkmans, 2008, 42). Accordingly, economic theories of integration fall short of providing the full picture of the costs and benefits of further integration.

However, the same holds for the economics of federalism literature, which includes the value of diversity and institutional aspects, but essentially ignores the role of the internal market. Economic theories of federalism do not take into account that a decentralised system may involve high costs due to barriers that hamper the free movement of goods, services, capital and persons across countries, and that limit competition on the markets. The explanation offered by Pelkmans for this lack of attention for the internal market is, that economic federalism has a tradition in public economics and builds on the assumption that, in a federation, the internal market simply is a single market (Pelkmans, 2008, 40). The practice of federations is much more complex, as is illustrated by the fact that we observe fragmented markets even in mature federations such as the United States and Canada. A key difference between these federations and the EU is, that in these countries the federation is generally accepted as 'given', whereas in the EU the benchmark is autonomy of the Member States. This makes further harmonisation to establish an internal market a more contested issue in the EU, where costs of fragmentation of the internal market might be consciously accepted in the light of higher costs of centralisation of policies (Pelkmans, 2008, 41). This explanation is not fully satisfactory from a theoretical perspective. The lack of attention for the internal market in economic federalism remains problematic, since the costs

of fragmented and monopolistic markets when policies are decentralised should be a consideration in the optimal allocation of regulatory powers to governmental levels.

Consequently, each of the economic approaches to integration is somewhat incomplete as to the costs and benefits involved in harmonising rules and centralising regulatory powers. The economic theories of international trade and federalism have to be seen as complementary theories, which are both necessary for a sound economic analysis of market integration (Kerber, 2016, 16). An integrated theory that combines the conclusions from both streams of literature is still missing. It appears that there may be a trade-off between establishing the optimal regulations and policies in different states, and ensuring a proper functioning of the internal market without costs for cross-border trade (Kerber, 2016, 5). Hence, an integrated analysis would have to find the point at which the additional benefits for the functioning of the internal market no longer outweigh the costs of further centralisation in terms of matching local preferences, as well as dynamic effects of policy learning and regulatory competition. Several considerations may affect at which point this optimal level of harmonisation could lie.

First, as integration progresses further, the welfare effects of further integration become more contestable. The positive welfare effects of removing tariffs can usually be easily shown (Pelkmans, 2006a, 101 e.f.; Krugman et al., 2015, chapter 10). The analysis becomes more complex regarding non-tariff barriers and in the context of positive integration, such as the harmonisation of food and safety standards or other consumer protection rules. This is due to two effects: on the one hand the costs of centralisation increase as integration progresses, whereas on the other the benefits for the internal market do not necessarily increase, and may even decrease.

First, whereas initial integration measures mainly involved removing barriers, such as removing tariffs and other negative integration measures, deeper integration increasingly requires positive harmonisation as well. This means that a common policy is introduced to replace the diverging national policies. However,

Member States may have had legitimate objectives for choosing their particular policies, and depending on the local conditions and preferences there may be good economic reasons for their chosen policies to vary across countries. A uniform European policy may then not fit well for the different regulatory problems in the Member States (Kerber, 2016, 5-8). Moreover, as integration progresses, the policies affected by harmonisation may become more salient to citizens. For example, Member States have been reluctant to accept harmonisation of private law, because they feel that this is part of their legal culture and national identity (Wilhelmsson, 2002). In comparison to bureaucratic rules or technical standards, local preferences are likely to be stronger with regard to these more salient topics. As countries are more deeply integrated, further integration is thus likely to affect policies for which Member States' preferences are stronger and more heterogeneous. Consequently, the welfare costs of further integration are likely to be increasing.

Secondly, the beneficial effects of these additional harmonisation measures are not necessarily increasing as integration becomes deeper, and may even be decreasing. For example, import tariffs may have been a more costly barrier to trade than differences in consumer protection rules or contract law are. Particularly when compared to more practical barriers such as language differences, it can be questioned to what extent harmonising consumer and contract rules makes a difference in firms' decisions to offer their goods and services abroad.[58] Although the most costly obstacles may not necessarily have been removed first - it may rather have been the obstacles that met the least political resistance - it could be the case that today's harmonisation measures concern more sophisticated, and less blatant barriers to the functioning of the internal market. There may always be additional possibilities to be found that could make the internal market more 'complete', but their effects may become smaller and more remote. All in all it appears that the welfare benefits of further integration may be decreasing, and at best are staying the same.

If the costs of further integration are increasing and the benefits are staying the

[58] This issue is further discussed in chapter 4 below.

same or decreasing, this means that the net gains of integration are declining. It also means that there is a point where further integration is no longer desirable, as illustrated in Figure 3.1.

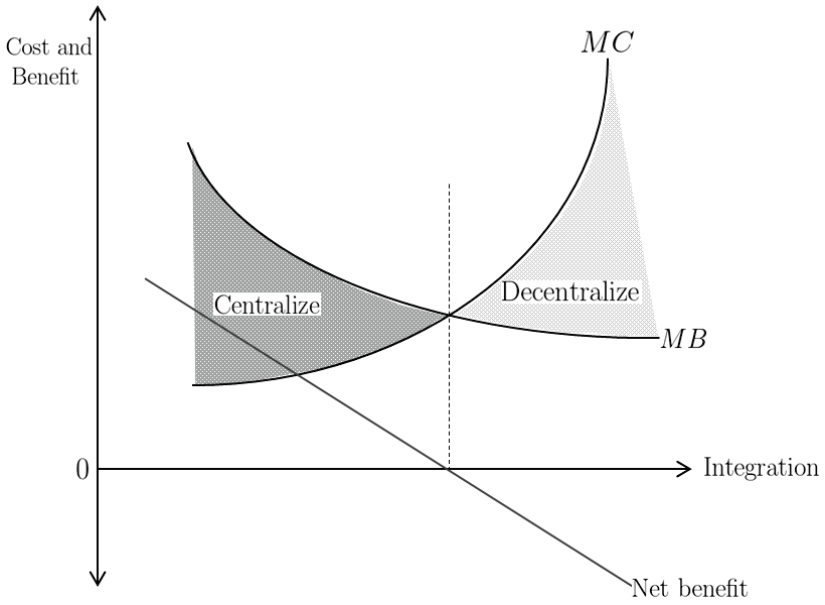


Figure 3.1: Marginal costs and benefits of integration

A second remark as to an integrated theory of trade and federalism is that institutional arrangements become more relevant as countries become more deeply integrated. More advanced stages of integration are accompanied by more and deeper positive harmonisation, which requires more institutional organisation and coordination. There is an increasingly large role to play for institutional considerations such as the possibilities for economies of scale, the possible responses of governmental actors to externalities and the scope for and likely results of regulatory competition. As a consequence, the insights of economics of federalism should have more weight for later stages of an economic integration process.

3.5 Conclusion

Overall, an overarching economic analysis of integration would need to take account of the effects of integration on both obstacles to trade and competition in the internal market, as well as on the correspondence of policy with heterogeneous preferences and other broader welfare aspects of different levels of policy centralisation. The insights of the economics of integration appear especially relevant in earlier stages of integration, whereas the considerations of economic federalism gain importance for analysing the effects of deeper integration. From a methodological perspective, deeper integration requires an approach resembling the one used in the economics of federalism, of allocating policies to the appropriate level of government, rather than Balassa's idea of gradually increasing integration.

For European integration, this means that we are at an advanced stage where new harmonisation proposals should focus on the question of whether we need for uniform rules given the heterogeneity in preferences, possibilities for policy learning and competition, and other welfare effects. With respect to removing barriers to the internal market and enhancing trade and competition, this chapter has illustrated that not only the *differences* between rules should be considered, but also the *substance* of the uniform rules that are to replace the national regulations. The reason is that the substance of the applicable rules may represent obligations or benefits, for example on firms and consumers when considering consumer protection. As a result, harmonising these rules may affect their decisions on the internal market not only through a reduction in the costs that existed due to legal fragmentation, but also via costs to comply with these rules. In sum, arguments why European integration is needed and desirable should consider several other aspects besides how differences between national rules hamper the internal market.

Nevertheless, this is not observed in the reality of European policy making. European policy proposals are required to demonstrate compliance with the principles of subsidiarity and proportionality, that is, explain why the objectives of the proposed measure cannot be sufficiently achieved by the Member States, and why

they can be better achieved at Union level. However, in practice this explanation is often reduced to an assertion that the principles have been complied with. In particular, this chapter has illustrated the problem of defining legal diversity itself as an obstacle to the internal market, as is done in many internal market policy proposals. Such an approach leaves little room for a real subsidiarity test, meaning a test that can result in the finding that harmonisation is not desirable. The reason is that if differences between legal rules are considered to be a barrier to the internal market, it is evident from the start that Member States cannot solve this problem and EU action is required.

The European courts have not objected to this approach, which essentially allows the European legislator to harmonise rules whenever differences between rules across Member States exist. The range of possibilities to harmonise under Article 114 TFEU is particularly wide since this competence is not limited in subject matter. Although the Court has expressed that this competence is no *carte blanche* for the EU to harmonise rules, the limits it has defined in its judgements leave the European legislator considerable discretion.

The lack of strict conditions to harmonise rules for improving the internal market is undesirable, both in light of the economic insights regarding welfare, as well as in light of societal concerns of unbridled and excessive harmonisation of rules on the European level. Nevertheless, the notion of a broader welfare approach instead of a pure internal market view has reached the European legislator as well. In the 2010 Monti report regarding the single market, then Commission President Barroso's mission letter noted that '[t]he crisis has induced some critical reconsideration of the functioning of markets', and 'enhanced concerns about the social dimension'. He concluded that this calls for 'a fresh look at how the market and the social dimensions of an integrated European economy can be mutually strengthened'. One way appears to be to put the value of heterogeneous preferences and welfare on an equal footing with internal market benefits. The next chapter introduces a framework for doing so in the context of consumer contract rules.

Chapter 4

Harmonising Consumer Contract Law: Effects on Trade and Welfare

The previous chapter concluded that when rules are harmonised to improve the internal market, not only should the transaction costs related to differences in these rules be considered, but also the compliance costs resulting from the substance of the rules. Harmonisation of rules does not only entail taking down a barrier to trade, it also involves setting a new, common, standard. This standard will, inevitably, represent a compromise between the pre-existing national standards. Consequently, firms and consumers in the various Member States are likely to face different obligations and rights under harmonised rules than under the prior national rules. Therefore, when studying the effects of harmonisation on cross-border trade, one must not only examine the impact on costs of legal differences, but also on compliance costs.

A broader welfare analysis, however, should also consider citizens' preferences for rules and regulation, which may differ across countries due to the particular culture, income level or other conditions. This chapter aims to illustrate the rel-

evance of heterogeneous preferences in the context of harmonisation targeted at improving the internal market, by studying harmonisation and trade in a vertical differentiation model. The chapter considers the question of whether harmonisation enhances welfare when harmonisation reduces the costs of legal differences but consumers differ in their preferences for rules. The findings are applied to the field of consumer law.

4.1 Introduction

Consumer law is an area on which European harmonisation has had a profound effect during the last four decades. Harmonisation in this field is generally based on the legislative competence to improve the internal market laid down in Article 114 TFEU. Therefore, the EU legislative initiatives in consumer law usually focus, at least in part, on removing barriers for consumers to cross-border shopping. In the last decade, the European legislator has shifted its harmonisation approach from minimum to full harmonisation in the area of consumer contract law. The full harmonisation approach means that Member States are no longer allowed to maintain or introduce stricter rules than the EU standard, as they were under minimum harmonisation. Full harmonisation was introduced with the Consumer Rights Directive (2011),[1] which has been heavily criticised in the literature. Several scholars argued that the European Commission overstates the likely benefits of full harmonisation on cross-border shopping by consumers, and understates the variation in preferences for consumer protection across Member States.[2]

Despite the critique, in December 2015 the European Commission issued a new proposal for full harmonisation in its proposed Directives on contracts for the online and distance sale of goods, and on contracts for the supply of digital content ('Proposed Digital Contracts Directives').[3] These new proposals illustrate that

1 Directive 2011/83/EU on Consumer Rights, OJ L 304/65.

2 See subsection 4.3.2 below.

3 Proposal for a Directive on certain aspects concerning contracts for the supply of digital content, COM (2015) 634 and Proposal for a Directive on certain aspects concerning contracts for the online and other distance sales of goods, COM (2015) 635.

full harmonisation in the area of consumer contract law is there to stay, raising the question of its desirability again.

This chapter starts out by analysing the conditions under which harmonisation is desirable using a vertical differentiation model. In this model the applicable legal standard affects the quality of goods as perceived by consumers, who differ in taste for quality. The model considers two countries that are each served by a monopolist if the costs of legal differences of firms to sell abroad are prohibitively high. The model is used to study the effect of harmonising the standards on consumer surplus and welfare. Harmonisation is found to have two opposing effects on consumer surplus and welfare. First, as the costs of legal differences decrease, thanks to harmonisation, firms may offer their products abroad, thereby enhancing competition and reducing prices. This *price effect* increases consumer surplus. Secondly, however, harmonisation also reduces the range of quality levels of the goods available to consumers, the *quality differentiation effect*. As a result, some groups of consumers will lose out because they will no longer be able to purchase goods of their preferred quality. The model illustrates that harmonising rules involves a trade-off between enhancing competition on the one hand, and ensuring that policy corresponds to local preferences on the other. Harmonisation is only welfare improving if the beneficial effects on competition are sufficiently large, and the differences in preferences for rules are sufficiently small.

The theoretical literature on minimum quality standards developed in the context of vertical quality differentiation models, such as Gabszewicz and Thisse (1979) and Shaked and Sutton (1982). Ronnen (1991) demonstrates that mild minimum quality standards improve welfare in a duopoly where firms compete in prices and incur fixed quality costs. Similar results are obtained by for example Crampes and Hollander (1995) and Chen et al. (1995) who assume that quality improvements costs are variable. Motta and Thisse (1999) extend the model to two countries with each two firms, comparing the effects of environmental quality standards in autarky with a free trade setting. In the two-country model of a vertically differentiated duopoly developed by Boom (1995), very different quality standards may lead firms not to enter the foreign market, so that the legal differences operate as

a barrier to trade. Petropoulou (2013) considers harmonisation of quality standards in a two-country vertical differentiation model. She analyses how countries choose to set their minimum quality standards and studies the effects on trade and welfare of a harmonised standard as compared to the minimum quality standards chosen by the countries. Firms can have distinct qualities domestically and abroad, an assumption that is employed in the model presented in this chapter as well. Petropoulou finds that international trade gives rise to cross-country externalities that result in inefficient national quality standards, either too lax or too tough relative to the standard that would maximise combined welfare of the countries. Petropoulou finds that trade flows are lower under minimum standards than under the optimal standards.

The rest of the chapter is organised as follows. Section 4.2 lays out the model, first considering a setting of autarky, followed by an overview of the possible equilibria depending on the magnitude of the costs of legal differences, and finally considering the effect of harmonising the quality standards. Section 4.3 applies the findings to the full harmonisation approach pursued in the field of EU consumer protection. Subsection 4.3.1 discusses the evolution of EU consumer law rules, followed by an overview of the debate regarding full harmonisation, and particularly the economic considerations in harmonisation brought forward in light of the Consumer Rights Directive, in subsection 4.3.2. Subsection 4.3.4 provides an empirical overview that was conducted based on survey data, in order to give more insight into the importance of consumer rules for consumer online shopping behaviour. Section 4.4 offers concluding remarks.

4.2 Model

4.2.1 Set-up

Two countries, H and L, initially have domestic monopolists who sell a competing product. The quality of the product in Country $i = H, L$ is $k_i > 0$, with $k_H > k_L$

without loss of generality.[4] Consumers have tastes for quality in Country i given by $\theta_i \in [0,1]$, distributed according to the continuous density function $f(\theta_i) \sim U[0,1]$. Each consumer derives utility only from the first unit of purchase, so he buys at most one unit of the product.

Each country is served by a non-discriminating monopolist, that charges a per unit price of p_i and faces a marginal cost of c_i. These marginal costs are related to quality (k_i), as will be further discussed below. There are no fixed costs.

In subsection 4.2.2 autarky is considered, where a monopolist serves its domestic market only. In subsection 4.2.3, this setting is compared with a setting where trade can take place between the two countries. Various possible outcomes are discussed, depending on the magnitude of the costs of legal differences. As part of this analysis, the effects on demand and welfare of harmonising quality standards between the two countries are considered. A key result is that harmonisation of the quality standards may lower consumer welfare. Subsection 4.2.4 revisits the assumption that consumers value consumer protection.

4.2.2 Autarky

In this setting, the two countries are served only by their own monopolists and the consumers are not able to benefit from the availability of other qualities elsewhere. The reason may be that trade barriers make it prohibitively costly for the firms to sell to the foreign country. This setting can serve as a benchmark for settings with trade and harmonisation.

In autarky, the key question is whether the monopolist would want to serve the whole of his domestic market.[5] Since consumers' tastes are given by $\theta_i \in [0,1]$, some consumers are not willing to buy the product at the price charged by the

[4] Quality can be thought of in terms of consumer protection rules: the stronger the protection for consumers offered with the good in terms of, say, cooling off period and warranty, the higher the quality perceived by consumers. See further subsection 4.2.4 below.

[5] A necessary condition for this is that $\theta_i > 0$ since no consumer would purchase a product whose quality they did not appreciate. This assumption is employed throughout the chapter.

monopolist. Consumers with a θ_i of 0 do not purchase a good at any positive price. As a result, domestic monopolies serve only part of their market. For a given price, all consumers with tastes for quality above $\tilde{\theta}_i$ will buy a unit, where $\tilde{\theta}_i$ is defined by

$$\tilde{\theta}_i k_i - p_i \equiv 0 \quad \Rightarrow \quad \tilde{\theta}_i \equiv \frac{p_i}{k_i} \tag{4.1}$$

The monopolist sets his price p_i^m to maximise his profits π_i, solving

$$\max_{p_i} (p_i - c_i) \left(1 - \frac{p_i}{k_i}\right) \tag{4.2}$$

The first-order condition is

$$1 - \frac{2p_i}{k_i} + \frac{c_i}{k_i} = 0 \quad \Rightarrow \quad p_i^m = \frac{k_i + c_i}{2} \tag{4.3}$$

Now profit can be computed:

$$\begin{aligned} \pi_i &= \left(\frac{k_i + c_i}{2} - c_i\right) \left[1 - \left(\frac{k_i + c_i}{2k_i}\right)\right] \\ &= \left(\frac{k_i - c_i}{2}\right) - \left(\frac{k_i - c_i}{2}\right) \left(\frac{k_i - c_i}{2k_i}\right) \\ &= \left(\frac{k_i - c_i}{2}\right) - \left(\frac{k_i - c_i}{2}\right)^2 \frac{1}{k_i} \end{aligned} \tag{4.4}$$

Expected consumer surplus can also be computed:

$$ECS_i = \frac{1}{1 - \tilde{\theta}_i} \int_{\tilde{\theta}_i}^{1} \theta_i f(\theta_i) d\theta_i k_i - p_i \tag{4.5}$$

Evaluating this integral and substituting p_i for the expression in 4.3, it can be

found that consumer surplus is positive provided that $k_i > c_i$. This assumption, which entails that the costs to comply with the standard do not outweigh the quality standard, is also required elsewhere in the model, and it is assumed throughout the chapter that it holds.

4.2.3 Allowing for the possibility of trade

Now consider that each monopolist could offer its products abroad as well. The quality regulation applies, so that each firm can offer its products in the other country only if it meets the local quality standard. For Firm H this means offering the good at a lower quality abroad, and for Firm L it means offering at a higher quality abroad. In both cases, the foreign firm incurs the same compliance costs for its exports as the domestic firm for its domestic sales.

This means that there is no quality differentiation within each country. However, consumers may go abroad and purchase a product produced at a different standard. As long as the quality standards in the two countries differ, the goods are vertically differentiated across the countries. It is assumed that potential entry into the market is only by the two monopolists in each of the two markets. The markets are segmented, and therefore, each firm chooses the price it will set in each of the two markets independently.[6] Consequently, the firms are able to differentiate the quality of their exports from the quality of their domestic sales. Within each market, the firms can supply goods of a single quality level k_i.

Assume that, when selling abroad, firms incur transaction costs based on the difference in the legal standards across the two countries. For example, they have to research and understand the legal environment in the potential importer's country, need to produce suitable labelling and packaging, or may need to modify their production process for each unit produced.[7] These costs of legal differences are denoted by z_i. The costs of legal differences could be a fixed cost, working as an entry barrier, or a variable cost, depending on the amount of sales. In what

[6] On the segmented market hypothesis, see Helpman (1982) and section 3.4.2 in chapter 3.
[7] See further section 4.3.2 below.

follows, these costs are assumed to be a variable cost, such that the marginal costs of a firm to sell in the foreign market are:

$$MC_j = c_i + z_j \tag{4.6}$$

Assuming that the firms compete with each other in a Bertrand fashion (i.e. on price), various equilibria can arise, depending on the magnitude of firms' costs of legal differences z_i:

1. **Prohibitively high** z_i: there is no trade, prices are at monopoly level;
2. **Moderately high** z_i**:** there is no trade, prices are below monopoly prices;
3. **Sufficiently low** z_i**:** there is trade and standard Bertrand results arise;

In what follows, each of these possibilities is discussed.

1. Prohibitively high z_i

If the costs of legal differences z_i are positive, one reasonable strategy for the domestic firm might be to set the price just high enough to keep the foreign competitor out of the market. This is the limit price, denoted by $\overline{p}_i$. If the foreign firm were to enter, the firms would engage in Bertrand competition. The limit price equals the marginal costs of the foreign firm, since below this price the foreign firm is not able to sell at a profit:

$$\overline{p}_i = MC_j = c_i + z_j \tag{4.7}$$

The threat of entry of the foreign firm only affects the price set by the domestic firm if the limit price is lower than the monopoly price. If, conversely, the costs of legal differences are so high that the limit price exceeds the monopoly price, the domestic monopolist has no reason to change its price as compared to the

autarky setting. In this case the limit price is not really a limit: the domestic firm simply sets its profit-maximising price, ignoring the foreign firm. Potential competition has no constraining effect on the price. Consequently, this setting occurs if $\overline{p}_i > p_i^m$, which is the case if the costs of legal differences are such that:

$$c_i + z_j > \frac{k_i + c_i}{2} \quad \Rightarrow z_j > \frac{k_i - c_i}{2} \tag{4.8}$$

where the monopoly price from equation 4.3 above has been used. In this case, the market can be treated as a standard monopoly. No trade occurs, and the results resemble the autarky setting discussed above.

2. Moderately high z_i

A second possibility is that z_i are not so high that the domestic firm can continue charging its monopoly price, but it can keep the foreign firm out of the market by charging the limit price. This situation occurs if the monopoly price exceeds the limit price ($p_i^m > \overline{p}_i$), and the costs of legal differences are such that

$$z_j < \frac{k_i - c_i}{2} \tag{4.9}$$

At this level, the foreign firm could sell profitably abroad if the domestic firm would charge its monopoly price. The domestic firm's best response is to adopt a price just below the price that would give the foreign firm enough profit to justify entry. Hence, the domestic firm now charges the limit price ($\overline{p}_i$). If the domestic firm would charge a higher price, the foreign firm would enter the market, the firms would undercut each other until the limit price is reached, and the two firms would split the market. Since the domestic firm sells at a profit, splitting the market at the limit price necessarily yields lower profits than serving the entire market just below this price. Consequently, in this setting the domestic firm will serve the entire market and there is no trade from sales by the foreign firm. However, potential competition disciplines the domestic firm's price. The limit

price binds, in that the domestic firm would set a higher price but for the threat of entry by the foreign firm.

Additionally, there is the threat of consumers shopping abroad. Assume that, when consumers purchase from the foreign firm, they incur the costs of legal differences equal to t. Consumers now choose between purchasing one unit from firm H, purchasing one unit from firm L, or making no purchase. Bearing in mind that consumers' tastes for quality in Country i are given by $\theta_i \in [0,1]$, consumption of one good at quality k_i and price p_i gives the following utilities for a consumer from, say, the low quality country:

$$U = \begin{cases} \theta_i k_L - p_L & \text{if he buys a low quality good} \\ \theta_i k_H - p_H - t & \text{if he buys a high quality good} \\ 0 & \text{otherwise} \end{cases} \tag{4.10}$$

Let $\hat{\theta}_i$ be the threshold consumer, who is indifferent between purchasing a high (low) quality product domestically or a low (high) quality product abroad. Consumers with strong preferences for quality (i.e. with $\theta_i > \hat{\theta}_i$) will purchase the good produced by the high-quality supplier, as long as the costs of legal differences t are not prohibitively high. Consumers with $\theta_i < \hat{\theta}_i$ will purchase the low quality good at home. The threshold consumer in countries H and L can be defined as follows:

$$\begin{aligned} \hat{\theta}_H &= \frac{p_H - p_L - t}{k_H - k_L} \\ \hat{\theta}_L &= \frac{p_L - p_H - t}{k_L - k_H} \end{aligned} \tag{4.11}$$

Plugging the prices into the indifference condition yields

$$\hat{\theta}_H = \frac{c_H + z_L - (c_L + z_H) - t}{k_H - k_L}$$
$$\hat{\theta}_L = \frac{c_L + z_H - (c_H + z_L) - t}{k_L - k_H} \tag{4.12}$$

In what follows, it is assumed for convenience that firms face the same costs of legal differences related to selling abroad ($z_H = z_L$). Consequently, in the indifference conditions these costs cancel out:

$$\hat{\theta}_H = \frac{c_H - c_L - t}{k_H - k_L}$$
$$\hat{\theta}_L = \frac{c_L - c_H - t}{k_L - k_H} \tag{4.13}$$

Hence, if costs of legal differences are at a moderately high level, there are two channels through which the firms' pricing decisions are restricted: the threat of entry by the foreign firm, and the risk that domestic consumers purchase abroad.

Harmonising the quality standards

Next, the effects of harmonising quality regulation are considered. It is studied how harmonisation affects the threshold consumer in country H, who is indifferent between purchasing high quality domestically or low quality abroad. In particular, 'closer harmonization' is considered, meaning that k_L is raised, to get closer to k_H, which is fixed at $\overline{k}_H$.[8]

[8] This resembles the EU approach in the area of consumer protection of imposing minimum standards, in which standards below the minimum standard are required to increase, but higher standards are left untouched.

Using equation 4.13 for the threshold consumer in country H, the effect on $\hat{\theta}_H$ of raising k_L, while fixing the high standard k_H at the level $\overline{k}_H$, is as follows:

$$\frac{\partial \hat{\theta}_H}{\partial k_L}\Big|_{\overline{k}_H} = \frac{(k_H - k_L)\left(\frac{\partial c_H}{\partial k_L} - \frac{\partial c_L}{\partial k_L}\right) - (c_H - c_L - t)(-1)}{(k_H - k_L)^2} \gtreqless 0 \tag{4.14}$$

For $\hat{\theta}_H > 0$ it must be that $c_H - c_L - t > 0$ and $k_H - k_L > 0$, given that $k_H > k_L$. This means that the second part of the numerator, '$-(c_H - c_L - t)(-1)$', must be positive. Assuming that the domestic production costs are not affected by the foreign standard, it is the case that $\frac{\partial c_H}{\partial k_L} = 0$. Recall also that producing at a higher quality level is costly, so that a higher (lower) domestic quality standard raises (lowers) costs: $\frac{\partial c_L}{\partial k_L} > 0$.

Under these assumptions, the first part of the numerator, $(k_H - k_L)\left(\frac{\partial c_H}{\partial k_L}\right)$, is negative. Since $(k_H - k_L)^2 > 0$, the above analysis means that $\frac{\partial \hat{\theta}_H}{\partial k_L}\Big|_{\overline{k}_H} \gtreqless 0$.

Consequently, an increase in the foreign, low, standard while the domestic, high, standard maintains the same has an ambiguous effect on the marginal consumer in country H, who is indifferent between purchasing the high quality domestically or the low quality abroad. This result can be interpreted as follows. For consumers in country H, an increase in the foreign standard has the following two effects. First, a fraction of consumers who preferred to go abroad to get a cheap, lower quality product, will after harmonisation instead choose to buy the more expensive, higher quality product in their own country. The intuition behind this result is that an increase in the foreign standard reduces the variety between the products, while the costs of consumers to shop abroad (t) remain. For some consumers, it will no longer be worthwhile to purchase abroad when the quality to be obtained there does not differ much from the domestic product. At the same time, harmonising the standards lowers the prices in both countries through the reduced costs of legal differences that firms incur. This second effect allows the firms to enter into the foreign market at a lower price as costs of legal differences decrease, so that in order to keep out the foreign firm the domestic firm will have to lower its price.

Thanks to this beneficial effect of harmonisation on competition, consumers can get their preferred quality at a lower price than before, leading more consumers to go abroad and get it.

If harmonisation of the standard reduces the transaction costs t of consumers, in addition to reducing the costs of legal differences z_i of firms, the effect of harmonisation on the marginal consumer is smaller. In this case, harmonisation reduces the difference between the quality obtained abroad and that obtained domestically, but at the same time reduces the costs of purchasing the product abroad. The net effect of harmonisation then depends on the magnitude of the reduction in consumers' transaction costs as compared to lost quality variation.[9]

Proposition 4.1. *Harmonisation of quality standards by increasing the lowest standard has an ambiguous effect on the fractions of consumers in the country with the high standard that prefer to buy domestically or abroad.*

Welfare effects of harmonisation

What are the welfare effects of such quality harmonisation? The effect on welfare is considered when the lowest quality standard approaches the higher foreign standard. Welfare in country H depends on the consumer surplus and the firms' profits:

$$W_H = CS_H + \pi_H \tag{4.15}$$

The firms' profits decrease as the lower quality standard, k_L, approaches k_H via harmonisation. The reasons are that firms have fewer possibilities to differentiate their products, and the reduction in the costs of legal differences increases the competitive threat of the foreign firm, both of which reduce prices.

[9] The model did not endogenise the effects of harmonisation on consumers' transaction costs, to keep the model tractable. Including the effect of harmonisation on consumers' transaction costs could be a way to extend this model in future research.

The relevant question is whether the effects of harmonisation on consumer surplus are positive, considering that, on the one hand, harmonisation may lower prices by reducing the costs of legal differences and allowing entry by the foreign firm, but on the other pushes the quality levels closer together, reducing the variety in quality available to consumers. Consumer surplus is defined as follows:

$$CS_H = \theta_H k_H - p_H \tag{4.16}$$

Expected consumer surplus in country H, where the distribution of taste is denoted as $f(\theta_i) \sim U[0,1]$, is as follows:

$$\begin{aligned} ECS_H &= \int_0^{\hat{\theta}_H} \theta f(\theta) d\theta k_L - p_L - t + \int_{\hat{\theta}_H}^1 \theta f(\theta) d\theta k_H - p_H \\ &= \frac{\theta^2}{2} \Big|_0^{\hat{\theta}_H} k_L - p_L - t + \frac{\theta^2}{2} \Big|_{\hat{\theta}_H}^1 k_H - p_H \\ &= \frac{\hat{\theta}_H^2}{2}(k_L - k_H) + \frac{k_H}{2} - p_H - p_L - t \end{aligned} \tag{4.17}$$

Similarly, in country L consumer surplus is defined as follows:

$$ECS_L = \frac{\hat{\theta}_L^2}{2}(k_H - k_L) + \frac{k_L}{2} - p_H - p_L - t \tag{4.18}$$

Now, the effects of harmonisation on consumer surplus are considered by again looking at the effect of increasing the lower standard k_L, while fixing the higher standard k_H at the level $\overline{k}_H$:

$$\frac{\partial ECS_H}{\partial k_L}\Big|_{\overline{k}_H} = 2\frac{\hat{\theta}_H}{2}\frac{\partial \hat{\theta}_H}{\partial k_L}(k_L - k_H) - \frac{\hat{\theta}_H^2}{2} + \frac{1}{2} - \frac{\partial p_H}{\partial k_L} - \frac{\partial p_L}{\partial k_L}$$

$$= \hat{\theta}_H(k_L - k_H)\frac{\partial \hat{\theta}_H}{\partial k_L} + \left(\frac{1 - \hat{\theta}_H^2}{2}\right) - \frac{\partial c_H}{\partial k_L} - \frac{\partial z_H}{\partial k_L} - \frac{\partial c_L}{\partial k_L} - \frac{\partial z_L}{\partial k_L} \tag{4.19}$$

Recalling the assumptions that $z_H = z_L$ and $\frac{\partial c_H}{\partial k_L} = 0$ and assuming that $\frac{\partial z_H}{\partial k_L} = \frac{\partial z_L}{\partial k_L}$, this can be simplified to:

$$\frac{\partial ECS_H}{\partial k_L}\Big|_{\overline{k}_H} = \underbrace{\hat{\theta}_H}_{(+)}\underbrace{(k_L - k_H)}_{(-)}\underbrace{\frac{\partial \hat{\theta}_H}{\partial k_L}}_{(\pm)} + \underbrace{\left(\frac{1 - \hat{\theta}_H^2}{2}\right)}_{(+)} - \underbrace{\frac{\partial c_L}{\partial k_L}}_{(+)} \gtreqless 0 \tag{4.20}$$

The effect of raising k_L to k_H on the expected consumer surplus has an ambiguous sign. Similarly in country L:

$$\frac{\partial ECS_L}{\partial k_L}\Big|_{\overline{k}_H} = \underbrace{\hat{\theta}_L}_{(+)}\underbrace{(k_L - k_H)}_{(-)}\underbrace{\frac{\partial \hat{\theta}_L}{\partial k_L}}_{(\pm)} + \underbrace{\left(\frac{1 - \hat{\theta}_L^2}{2}\right)}_{(+)} - \underbrace{\frac{\partial c_L}{\partial k_L}}_{(+)} \gtreqless 0 \tag{4.21}$$

The intuition behind this ambiguous effect is that harmonisation has two distinct effects on the consumer, which work in opposite directions.

1. (-) *Quality differentiation effect*: If the lowest standard, k_L, is forced up, the consumer from a high standard country has less benefit from going abroad. There is less variety in legal rules than in the decentralised setting.

2. (+) *Price effect*: If the costs of legal differences, z_H and z_L, drop as a result of k_L and k_H being closer together, the prices drop. This result resembles the standard argument of the economics of integration, that integration may foster trade and competition and thereby increase welfare.

Proposition 4.2. *Harmonisation of quality standards has an ambiguous effect on consumer surplus when consumers vary in their preferences for quality, because harmonisation lowers prices by reducing the costs of legal differences, but at the same time reduces choice in quality for consumers.*

The overall effect on consumer surplus and welfare depends on several factors. First, it depends on how harmonisation affects the costs of legal differences, and hence on the magnitude and shape of the function of $z_i(k_H, k_L)$. If z_i hardly drops as a result of bringing k_H and k_L closer together, the benefit of harmonisation disappears. Additionally, the function $z_i(k_H, k_L)$ could be marginally increasing. In an extreme case of marginally increasing effects of harmonisation, z_i only drops when $k_H = k_L$, meaning that only full harmonisation produces an effect on the costs, while some harmonisation does not help at all. Alternatively, $z_i(k_H, k_L)$ could be linear and gradually converge to 0 as the standards are further harmonised. A third possibility is that z_i drops quickly with the first steps towards harmonisation, and the benefits decrease as the standards are pushed more closely together (decreasing marginal benefits of harmonisation).[10] In the case of marginally increasing reductions in the costs of legal differences, no harmonisation or full harmonisation (where $k_H = k_L$) may both be preferable to a 'bit' of harmonisation that brings the standards slightly closer together. In the case of marginally decreasing effects of harmonisation on the costs of legal differences, by contrast, one may not want to go beyond this first step towards harmonisation.

A second relevant factor is whether harmonisation also reduces consumers' transaction costs. This aspect was not endogenised in this model to keep it tractable, but would be a possible way to extend the model in future research. As was discussed above, more consumers would still purchase abroad if harmonisation reduces consumers' transaction costs.

Thirdly, the overall effect on consumer surplus depends on the variation in consumers' preferences for quality. If these preferences are very similar, the cost of harmonisation in terms of reducing variety in quality standards is less problem-

[10] Compare also figure 3.1 in chapter 3.

atic. Vice versa, large divergences in preferences mean that more consumers will lose out when the quality standard is unified. In order to study this further, a possible extension of this model could endogenise the regulator's choice for the quality standard.

In sum, it was found that harmonisation has ambiguous welfare effects. On the one hand harmonisation may lower transaction costs of firms to sell abroad, thereby enhancing competition and lowering prices. This clearly benefits consumers. On the other hand, harmonising the standards reduces the variety of qualities available to consumers. Those consumers with a very strong, or very weak, preference for quality may no longer be able to purchase their preferred quality level. Given this tradeoff involved in harmonisation, it is relevant to know how harmonisation is likely to affect transaction costs, and if some harmonisation, or further harmonisation beyond a certain degree, is likely to decrease transaction costs.

It was also found that high transaction costs may prevent trade from happening. Two possibilities were discussed in which this occurs: Transaction costs may be so high that firms continue to act as a monopolist, or transaction costs may be low enough for the foreign firm to have a credible threat to enter the market, but the domestic firm has an interest in setting its price as to keep the foreign firm off the market. In what follows a final setting is discussed, in which transaction costs are sufficiently low to allow for trade to occur.

3. Sufficiently low z_i

If transaction costs are sufficiently low, it may no longer be of interest to the domestic firm to set the limit price, since the limit price is so low that it can make more profit by allowing the foreign firm to enter and share the market.

This setting occurs if firms face no transaction costs, since then the domestic firm can no longer keep the foreign firm off the market without selling at a loss himself. Firms then compete in a Bertrand duopoly and sell at price $\underline{p}_i = c_i$.

In the set-up of this model, the situation in which the domestic firm prefers to let

the foreign firm in the market rather than charging the limit price does not occur as long as transaction costs are positive ($z_i > 0$). This flows from our assumption that if trade occurs the firms enter into Bertrand competition, which drives the price down to the foreign firm's marginal costs. In this setting, the firms will share the market, the foreign firm will break even, and the domestic firm will still make profit z_i on each product because it does not incur transaction costs for his domestic sales. However, by setting the price only slightly higher, the domestic firm can capture the entire market and increase its profits, so he will prefer to do so.

This could be different if one considers some specific situations outside the model. For example, in the model it is assumed that the domestic firm is elastic in supply and can serve the entire domestic market. If, alternatively, the domestic firm has capacity constraints, he may prefer to charge a higher price and share the market with the foreign firm. The reason is that by charging the limit price, he would lose margin on each sale but would not gain all sales from the foreign firm, because he does not have the production capacity.

Another situation in which, even when transaction costs z_i are very low, the domestic firm may wish to charge a price above the limit price is when there are high fixed costs to enter into this particular market. The domestic firm needs to recover its initial investments, and the fixed cost serves as an entry barrier for the foreign firm.

4.2.4 If consumers do not care about quality

Throughout this model it was assumed that consumers, to different degrees, value the quality of a product and are willing to pay for it. One could think of the quality standard k_i as a standard of consumer protection that stipulates, for instance, the warranty for faulty products. The higher this standard is, the longer the consumer can rely on a warranty, meaning that the consumers will be able to get a replacement if the product is faulty for a longer period of time. This, in turn may translate into a higher quality product that is less likely to be faulty, if producing

at a higher quality is the least costly way for the producer to comply with the standard. Either way, the consumer will be able to benefit from the product for a longer period of time, and hence the higher the quality of the product may be perceived by consumers. The assumption of the model so far has been that consumers value the standard for consumer protection as a quality standard, and may be willing to pay for it.

By contrast, the Brander-Krugman trade model presented in chapter 3 assumed that consumers do not care about the level of consumer protection. The question of which assumption is more realistic is considered from an empirical point of view in Subsection 4.3.4 below.

If the assumption is revisited that consumers value quality in this model, now assuming that they all care very little, the following happens in terms of trade. In this case, the quality standard k_i works like a tax on the product. A higher standard increases the costs of the firms, while bringing no benefit to the consumer. If consumers all have a very low preference for quality θ_i, they will buy the cheapest product, subject to transaction costs. Some of them may not even purchase any good at all if quality standards are high. Recalling consumers' utility from equation 4.10, it can be seen that consumers from the country with the lowest standard will not buy abroad if their preference for quality is very low. They have no reason to purchase abroad, since the foreign product is more expensive due to the higher standard, and consumers have to incur transaction costs t to obtain it.

This is different for consumers from the country with the high standard (H). Their utility is defined as follows:

$$U = \begin{cases} \theta_i k_L - p_L - t & \text{if he buys a low quality good} \\ \theta_i k_H - p_H & \text{if he buys a high quality good} \\ 0 & \text{otherwise} \end{cases} \tag{4.22}$$

If transaction costs t are sufficiently low and the difference between the quality standards is sufficiently large, it pays off for consumers with a very low preference

for consumer protection to buy the cheaper product abroad. In particular, these consumers from the country with the high standard will purchase abroad if:

$$p_L + t < p_H \tag{4.23}$$

As the legal standards are harmonised, the countries' quality levels will move closer together, which for some consumers may no longer make it worthwhile to purchase the low quality good abroad. This also depends on how consumers' transaction costs are affected by harmonisation. Consumers with a weak preference for quality in the low protection country will be worse off if harmonisation pushes the lowest standard upward. In sum, if it is assumed that consumers only weakly value the level of consumer protection, the conclusion regarding consumers resembles that of the reciprocal dumping model that was presented in Chapter 3 that harmonisation reduces trade, because there is less to gain from purchasing abroad.

4.3 Applying the findings to consumer protection

Employing a vertical differentiation model has illustrated the ambiguous welfare effects of harmonising rules that affect the quality of goods from the perspective of consumers. As was discussed above, consumer protection rules may affect the quality of goods in the consumer's perception. This section discusses the implications of the findings from the analysis above for recent EU harmonisation initiatives in the area of consumer law. Subsection 4.3.1 provides a background of EU consumer law and explains the link with the internal market. Subsection 4.3.2 discusses the academic debate on the shift towards a full harmonisation approach, according to which Member States may no longer impose stricter standards than the EU standard, as they could under the prior minimum harmonisation approach. The full harmonisation approach is discussed in light of the findings of the vertical differentiation model, and against the background of the considerations of

federalism economics and integration economics more broadly. Subsection 4.3.4 critically examines the empirical support for the argument that differences in consumer protection hinder consumers from shopping across borders, by means of an analysis of survey data on the role that consumer protection and other factors play in consumers' online shopping behaviour.

4.3.1 Evolution of EU consumer law

This section provides a background of harmonisation in the field of consumer law and an overview of the most recent legislative initiatives. The field of consumer law has been profoundly affected by European intervention during the last four decades.[11] EU consumer contract law is largely created through the adoption of legislation which seeks to harmonise certain aspects of national law, requiring all national laws of the Member States to provide the same basic consumer contract rules. This has resulted in a set of EU rules for consumer transactions that is referred to as the 'Consumer Acquis', which is at the heart of European private law.[12]

European consumer law has been, and still is, largely based on the legislative competence of the internal market, laid down in Article 114 TFEU. The need to connect EU consumer protection initiatives to the internal market originally had constitutional motivations: the Treaty of Rome did not include a specific legal basis for a protective policy in the area of consumer law.[13] Consumer protection was formally given a legislative basis in 1987 with the adoption of the Single European Act, although consumer protection was constitutionally anchored within the internal market's legislative framework.[14] In the absence of a specific legal

[11] On 14 April 1975 the then European Community adopted its first Consumer Protection Programme, OJ 1975, C 92/1. While consumer protection also consists of regulations, such as safety standards, the focus in this chapter is on consumer contract rules. On the evolution of EU consumer law generally, see Weatherill (2005) or Micklitz et al. (2008).

[12] For an overview of the Consumer Acquis, see Micklitz et al. (2010).

[13] The Treaty of Rome only referred to the 'consumer' in two places: as one of the several beneficiaries of a common agricultural policy in Articles 39 and 40 EEC (now Articles 38-55 TFEU), and in the field of competition policy in Article 85 EEC (now Article 101 TFEU).

[14] Namely in Article 100A EEC, later Article 95 EC and now Article 114 TFEU.

basis, the first legislative instruments were adopted on the basis of (now) Article 114 TFEU, requiring a link between the EU consumer law instrument and the establishment or functioning of the internal market.[15] The European Commission turned the policy area of consumer law into a significant constituent of the European integration process, albeit as a by-product of the efforts to establish the internal market. The harmonisation of consumer rules was not an end in itself: most directives stated that the rationale was to create a 'level playing field' and overcome market fragmentation (Editorial, 2015; Bull et al., 2001). Consumer law has been characterized as instrumental to the completion of the internal market (Micklitz, 2002).

The European legislator placed consumers in the centre of the development of the internal market, on the basis that by granting consumers well-defined rights, they would be more willing to make cross-border purchases (Bull et al., 2014, 100). The consumer is 'viewed as a market player whose action (or inaction) is vital in constructing the single market' (Oughton and Willett, 2002, 303). The argument frequently brought forward in EU consumer protection initiatives is therefore that differences in legal rules across Member States hinder consumers from purchasing goods and services across borders. Arguably, consumers' uncertainty about whether rights familiar from domestic transactions will still be available when dealing with a trader in another jurisdiction will deter them from making such cross-border purchases. Harmonisation of consumer rules is thus deemed necessary to ensure that consumers are willing to shop cross-border, thereby contributing to the improvement of the internal market.

The Maastricht Treaty established consumer protection as an autonomous area of EU law by including a legal basis for consumer protection.[16] Nevertheless, the close relationship with the internal market has remained unchanged even with the adoption of the Lisbon Treaty.[17] Today's EU legislative proposals for consumer

[15] For an overview of the consumer protection instruments adopted in the 1980s, see e.g Editorial (2015).

[16] Maastricht Treaty, Arts. 3(s) and 129a.

[17] Article 12 TFEU reads 'consumer protection requirements shall be taken into account in defining and implementing other Union policies and activities'. Article 169, paragraph 1

protection are still primarily based on eliminating barriers to the functioning of the internal market. An example is the Consumer Rights Directive, published in 2011 and in applied since June 2014, which harmonises rules regarding consumer distance and off-premises contracts. The Directive notes that 'As a result of the fragmentation of national consumer laws, a trader wishing to sell cross border into another Member State will have to incur legal and other compliance costs to make sure he is respecting the level of consumer protection of the country of the consumer, as required by Rome I. This is a regulatory barrier to the completion of the internal market.'[18]

4.3.2 From minimum to full harmonisation

An important innovation of the Consumer Rights Directive was that it included a number of substantial provisions which impose a fixed European standard on the Member States, instead of the previously common minimum standards in consumer policy. This shift from minimum harmonisation to full harmonisation means that Member States are no longer allowed to deviate from the EU rules by imposing stricter standards. The reason to limit the Member States' discretion to have their own policies was to achieve a uniform consumer policy throughout Europe, without national variations. The Commission argued that such a uniform system would reduce transaction costs for firms supplying in various EU countries and enhance consumer confidence by ensuring them the same rights for a cross-border transaction as for a domestic purchase. By enhancing consumer confidence in the internal market and reducing business reluctance to sell abroad, the Directive aimed to contribute to the better functioning of the business-to-consumer

reads 'In order to promote the interests of consumers and to ensure a high level of consumer protection, the Union shall contribute to protecting the health, safety and economic interests of consumers, as well as to promoting their right to information, education and to organise themselves in order to safeguard their interests'.

[18] Directive 2011/83/EU on Consumer Rights. The Directive replaced Directive 97/7/EC on the protection of consumers in respect of distance contracts and Directive 85/577/EEC to protect consumers in respect of contracts negotiated away from business premises. The Rome I Regulation (EU Regulation 593/2008)), referred to in the Directive, governs the choice of law for contracts in the EU, laying down default rules.

internal market.[19]

The Commission justified the need for full harmonisation by referring to the remaining differences in rules under minimum harmonisation. Minimum harmonisation failed to result in the desired uniform rules in Europe, because Member States made use of the possibilities under minimum harmonisation to impose stricter rules that went beyond the EU standard. The Commission argued that the discretion under minimum harmonisation thus lay at the root of the problem of legal fragmentation.[20] Full harmonisation was expected to have a considerable positive impact on the retail market and to substantially reduce the administrative burden for firms.[21]

4.3.3 Economic considerations in harmonising consumer law

However, in the scholarly literature full harmonisation in consumer law has received considerable criticism. Several scholars approach the topic from a Law and Economics perspective, arguing that the economic arguments supporting full harmonisation are weak, and the arguments in favour of decentralisation are strong. This subsection summarises and extends this literature, taking into account the considerations of the economics of federalism and regulatory competition, discussed in Chapter 2, and in particular the findings of the vertical differentiation model presented in this chapter.

First the role of heterogeneous preferences is considered, followed by the relevance of dynamic effects and externalities in the context of consumer law, and finally discussing the effect on transaction costs of a harmonised EU consumer policy.

[19] Proposal for a consumer rights directive of the European Parliament and of the Council on consumer rights of 8 October 2008 ('Proposed Consumer Rights Directive'), COM (2008) 614/4, available at

[20] Proposed Consumer Rights Directive, p. 6.

[21] The expected reduction in administrative burden was based on the accompanying Impact Assessment, which makes calculations based on a 'consideration of the conditions created by the fragmentation of rules as a consequence of minimum harmonisation'. See European Commission (2011), Staff Working Paper: Executive Summary of Impact Assessment, Brussels, 11 October, p. 38. See also the Proposed Consumer Rights Directive, p. 6.

Heterogeneous preferences

As discussed, the Commission argued in the Proposed Consumer Rights Directive that full harmonisation is necessary because rules still differ considerably across Member States, as a result of Member States making use of the possibility to impose stricter standards under the minimum harmonisation approach. With this line of argument, the Commission apparently overlooks that the different resulting rules indicate that Member States vary in their preferences for the level of consumer protection (Smits, 2010; Faure, 2008, 441; Van den Bergh, 2007, 186-189). Generally, Nordic countries and Western-European Member States such as Germany and the Netherlands have stricter consumer protection rules in place than the Southern- and Eastern-European countries (Bull et al., 2014, 102).[22] The mere fact that legal rules differ between Member States thus supports diversity and decentralisation, in order to ensure that legislators can provide rules that correspond to the specific preferences of their citizens (Faure, 2008, 437; Rekaiti and Van den Bergh, 2000).

This advantage of differentiation of rules is not mentioned in the Proposed Consumer Rights Directive, which mainly discusses transaction costs savings. This limited focus on transaction costs savings would not be so problematic if the differences between Member States' rules were meaningless and uniformity would only have advantages. However, as mentioned, these differences may very well be related to varying preferences of citizens.

Uniformity creates the cost of lost differentiation, and a policy that corresponds less to the preferences of the citizens (Faure, 2008, 441; Van den Bergh, 2000; Ogus, 1999). This is particularly true given that a large part of consumer law consists of mandatory substantive rules that private parties cannot deviate from (Van den Bergh, 2007, 186). In contrast, when harmonisation concerns default rules, parties may still opt for a solution that suits their preferences better. In short, the objective of reducing transaction costs for consumers overlooks the value

[22] For a comparative analysis of Member States' consumer protection rules see Schulte-Nölke et al. (2008).

of diversity in policies that correspond to citizens' heterogeneous preferences.

The objective of the Consumer Rights Directive, next to reducing fragmentation in the law and fostering cross-border trade, is the 'achievement of a high level of consumer protection'.[23] However, the argument that European intervention is warranted to ensure a high level of consumer protection disregards the value of different policies respecting Member States' preferences. There is no general principle that establishes that any increase in the level of consumer protection will enhance consumer welfare (Epstein, 2013, 212). An increased level of protection comes at the cost of increased prices or services (Faure, 2008).

Aside from overlooking preferences, the argument that full harmonisation would lead to a higher level of consumer protection is also not true, at least not for all Member States. Unless the European standard is higher than all pre-existing standards in the Member States, full harmonisation leads to less protection than before at least for some consumers. In particular, in Member States that made use of the possibilities under minimum harmonisation to impose stricter rules, full harmonisation is bound to reduce the level of consumer protection (Bull et al., 2014, 102). This point of critique has been stressed in the context of the Proposed digital contract directives as well (Spindler, 2016; Smits, 2016; Loos, 2016). For the consumers for whom full harmonisation leads to less protection than before, full harmonisation may not increase their consumer confidence in the internal market (Wilhelmsson, 2004, 328). This was also illustrated by the trade model presented in Chapter 3. In sum, a higher level of consumer protection is, in itself, not a convincing argument in favour of harmonisation.

Nevertheless, it should be noted that, in light of the critique on draft versions of the Directive, the scope of full harmonisation was limited to certain 'key aspects' only. This limitation is laudable from an economic perspective, and illustrates the importance of the scope and reach of the harmonising effect of European rules. Gomez and Ganuza (2012) even stress that the harmonization strategy is as important a question as whether harmonising European private law is desirable in

[23] Consumer Rights Directive, Preamble and Article 1.

general. They show how different modes of harmonising private law, namely minimum harmonisation, full harmonisation and the co-existence of EU and Member State rules, are likely to result in different outcomes of harmonisation. As Mak (2009) notes, a limited scope may also lead to problems, such as different regulatory instruments overlapping and offering inconsistent rules for a certain legal situation. Using the example of the limited scope of maximum harmonization in the Product Liability Directive, she points out that in the development of legislation on consumer law, regard should be had of the wider legal framework in which these rules operate.

The existence of multiple legal frameworks has been named as a potential problem of the Proposed Digital Contracts Directives, which would in some Member States lead to the co-existence of at least five regimes that may be applicable to sales contracts (Loos, 2016, 2). Loos considers this unworkable, particularly since yet another separate regime is introduced for the supply of digital content (next to contracts for goods). According to Smits (2016), the two proposals seem to add to existing fragmentation of contractual remedies at the EU-level, despite the objective of these proposals to in fact reduce legal fragmentation. Loos expects that Member States will only agree to adopt the proposal for an Online Sales Direct if its scope is enlarged to include also on- and off-premises contracts (Loos, 2016, 3). Overall, in the case of the Proposed Digital Contracts Directives, various problems have been identified with the limited scope, calling for reconsideration or clarification (Spindler, 2016, Lehmann, 2016).

Dynamic effects

The full harmonisation approach of imposing fixed standards not only makes it impossible for Member States to continue tailoring their consumer policies to the national preferences, it also eliminates the possibilities to learn from alternatives abroad to improve legislation (Wihelmsson, 2000). Decentralised policy making allows experimentation with different consumer policies, which may improve the understanding of the effects of alternative legal solutions to similar problems

(Van den Bergh, 2007, 189). Moreover, mutual learning processes may alleviate the convergence of consumer law rules, resulting in spontaneous harmonisation rather than forced coordination by the European legislator. Potentially, also a competition for the best legal solution could occur (Wagner, 2002, 1012; Ogus, 1999, 412-413.).

At the same time, in the area of consumer law there appears to be a low risk of a 'race to the bottom', in which legislators would compete for the most lenient rules rather than the best rules. Whereas in environmental law or tax law states may gain by lowering their standards to attract firms, such a connection is not clear in the context of consumer law. It appears unlikely that firms will relocate plants to profit from lenient consumer laws abroad, particularly since it will not affect sales of these firms abroad (Van den Bergh, 2007, 198).

In sum, there appear to be substantial beneficial dynamic effects of diversity in consumer law, and a low risk of detrimental dynamic effects, providing further arguments against full harmonisation.

Externalities

Externalities do not appear to be of major importance in the context of consumer protection. For externalities to justify harmonisation, it would have to be shown that i) rules of Member States' consumers laws affect transactions with interstate effects and ii) it is impossible for national legislators to design consumer rules that fully internalise the negative externalities arising from interstate transactions (Van den Bergh, 2007, 196). These conditions are likely to be fulfilled for product liability rules. As Van den Bergh points out, product liability indeed was the first consumer topic covered by the European harmonisation process.[24] Contracts, in contrast, have fewer effects on third parties, since the agreed terms usually only concern the contracting partners. Although externalities may still arise for

[24] Namely the Council Directive 85/374 of 25 July 1985 on the approximation of laws, regulations and administrative provisions of the Member States concerning liability for defective products, OJ, 1985, L 210, 7.8.1985, pp. 29-33.

networks of contracts, where decisions on quality and price may have effects on others in the supply chain, national consumer laws may be able to cope with these externalities.

Transaction costs savings and enhanced trade and competition

Transaction costs in this context can be defined as costs to obtain information about the legal system applicable to the transaction, the contents of this system and the differences between the other system and the system of the contracting party (Ott and Schäfer, 2002, 207). It may be necessary to distinguish different types of parties to contracts and different types of transaction costs. Large companies with experience in international trade and a strong bargaining position may be able to draft their own contract terms, regardless of whether they deal with parties in their country or abroad. For small and medium-sized firms, transaction costs may not justify cross-border activity (Smits, 2005). Ribstein and Kobayashi (1996, 137) distinguish the following types of costs that can be reduced by uniformity: i) inconsistency costs that arise through inconsistent or divergent laws, ii) information costs to determine what law applies in each state, iii) litigation costs in the sense of costs to find out how to bring a claim in another state, iv) instability costs caused by changes in the law, v) externalities of efficiencies in the applicable rules that the central legislator can internalise, and vi) costs to draft legislation.

A central argument brought forward by the Commission for the Consumer Rights Directive is that consumers and businesses face substantial transaction costs due to the differences between Member States' rules.[25] This argument in favour of full harmonisation has been criticised in the literature.[26] First, the costs of harmonisation, which are not mentioned in the legislative proposal for full harmonisation, may be substantial Faure (2008). Faure refers to earlier harmonisation

[25] The Proposal mentions that 'The savings in terms of administrative burden on business wishing to sell cross-border would be high', p. 6.

[26] See generally e.g. Rott and Terre (2009), Whittaker (2009), Twigg-Flessner and Metcalfe (2009) Low (2010) and Loos (2010).

initiatives such as the Directive concerning product liability, for which transaction costs savings were minimal due to interpretation problems (Faure, 2008, 440-441; Van den Bergh, 1998, 146-147). When rules are harmonised by directive rather than by regulation, requiring implementation by the Member States, it is likely to remain necessary to understand national law in case a dispute arises (Twigg-Flesner, 2011). At the same time, the argument that the current differentiation of legal rules would limit cross-border trade wrongly assumes that complete harmonisation of rules is necessary to realise the ideal of an integrated European market. Counter examples such as the US and Switzerland show that an integrated market is reconcilable with differences in rules and competition between legal orders (Faure, 2008, 441). Moreover, trade is fostered by differences in marketing conditions, so that if all differences were to be removed there would be no inter-state trade (Faure, 2008, 437).[27] Similarly, Revesz notes in the context of harmonization of environmental protection rules that a level playing field, if it would be achieved at all, countries' comparative advantage that make trade would be destroyed (Revesz, 2000).

Wilhelmsson has doubts about consumers' knowledge of their rights even on a national level, let alone on the EU level, and about the impact of such (a lack of) knowledge on their behaviour (Wilhelmsson, 2004, 325).[28] If consumers do not know the content of their own consumer protection law, which Wilhemsson deems to be the case for consumers, it cannot be relevant for them to know that the law of another Member States is more or less identical to their own law. Hence, harmonisation of rules would not affect their cross-border shopping behaviour (Wilhelmsson, 2004, 328).

Additionally, even if consumers planning to engage in cross-border shopping were

[27] This is illustrated by the model presented in this chapter: as the standards are harmonised, there is less reason for consumers to purchase abroad. However, if harmonisation enhances competition, intra-industry trade may still arise, as was also discussed in Chapter 3 above.

[28] Nevertheless, even though consumers do not know their own consumer protection rules in detail, and have no knowledge about foreign rules, they may still believe or suspect that their own system of protection is better than that of other Member States. Wilhemsson finds some support for this in the Eurobarometer survey, but not in all countries, particularly not the Sourthern Member States (Wilhelmsson, 2004, 327).

aware of the applicable rules, and even if these rules would be fully harmonised, ensuring that the substantive law of another Member State offers consumers the same level of protection, consumers may refrain from cross-border shopping because of other, more practical difficulties. Namely, even if all consumer contract rules are fully harmonised, there will still be other differences affecting the costs of transacting abroad. These include differences in other legal rules, but also in their enforcement (Faure et al., 2008), and, perhaps more importantly, in other aspects such as language, income, and infrastructure (Van den Bergh, 2007, 202). Other scholars also doubts whether, for consumers, differences in national legal rules really constitute the main barriers to interstate purchases (Wilhelmsson, 2004). Consumers are more likely to refrain from shopping abroad because of fear of practical problems regarding possibilities for exchange and after-sale service that result from the fact that the consumer and the seller are located in different countries. Their main obstacles may be constituted by differences in distance, language, and culture (Cseres, 2005, 233). If legal rules are relevant, other areas such as value added tax may be more important to consumers (Faure, 2008, 438). Another more relevant area may be the enforcement of rules, allowing consumers to have possible problems with foreign sellers resolved (Wilhelmsson, 2004, 329). In sum, even full harmonisation of consumer law might not result in more cross-border shopping by consumers.

4.3.4 Does the level of consumer protection affect online shopping?

The claims in EU legislative documents in support of the argument that differences in consumer contract law among Member States hinder trade largely rest on the findings of the Flash Eurobarometer surveys conducted by the European Union. The value of these surveys as empirical support for the need for harmonisation has been questioned in the literature. Faure (2008, 443) highlights the methodological limitations of the surveys, pointing out that questionnaires asking respondents whether they would hypothetically trade more in the future if legal

barriers resulting from different legal rules were reduced is not the same as empirically examining whether they actually did. Moreover, respondents were not presented with the disadvantages of harmonisation (Hubbard, 2013; Wilhelmsson, 2004).

Despite these drawbacks, it is worthwhile to study whether the responses in the Eurobarometer surveys in fact support the argument that consumers are are deterred from shopping cross-border due to differences in the applicable consumer contract rules. As Wilhelmsson (2004) noted, it is difficult to see how harmonisation of consumer protection could enhance cross-border shopping if consumers are not aware of or not concerned about what rules apply. According to Wilhelmsson, it is unlikely that consumers would have knowledge of their national consumer law rules, let alone the rules that apply abroad. In this case, reducing the differences between these rules would not reduce transaction costs related to legal fragmentation, as the European Commission suggests.

In order to shed more light on the factors that are relevant for consumers' online shopping behaviour, the next sections analyse the percentage of consumers that engaged in online shopping - distinguished by domestic and cross-border, and in, as well as outside, the EU - as reported by respondents with i) different attitudes towards rules and institutions, and ii) different demographic and social characteristics. The data were compiled from the Flash Eurobarometer surveys conducted between 2009 and 2014, part of a trend survey called 'Consumer attitudes towards cross-border trade and consumer protection'.[29] The surveys were carried out in all Member States as well as Norway and Iceland. For each of the surveys around 25,000 respondents were interviewed via telephone, from different social and demographic groups.

A number of questions were selected that relate to the respondents' online shopping behaviour, from domestic as well as foreign retailers, their attitudes towards consumer protection rules and legal institutions, and their demographic and social characteristics. An overview of the questions and the possible answers can be

[29] The data are available via `www.gesis.org/eurobarometer-data-service/home/`.

found in Appendix A.

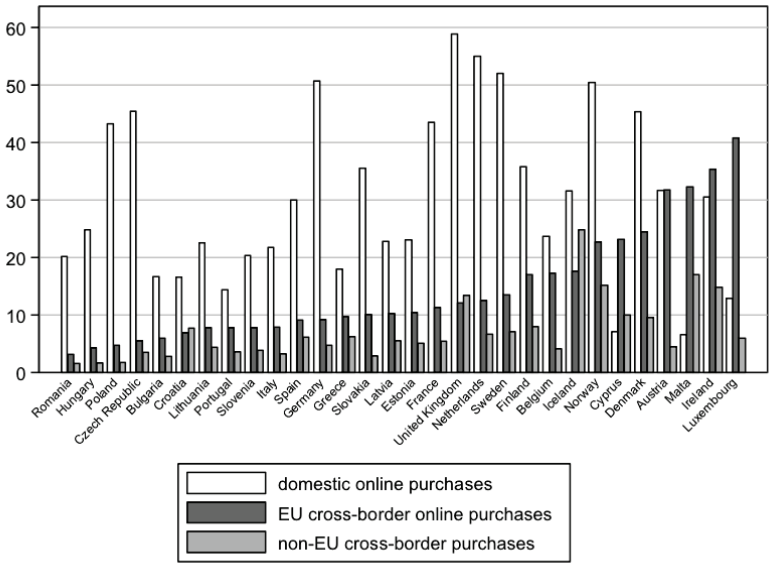


Figure 4.1: Online shopping by consumers across the EU, average 2009-2014

The percentage of consumers willing to shop online, and to shop from foreign sellers, differs markedly across Member States. Figure 4.1 shows the percentage of respondents per Member State that reported having made an online purchase in the previous 12 months, averaged over 2009-2014. The results are split by purchases from domestic retailers, foreign retailers from the EU and foreign retailers from outside the EU.

The popularity of online shopping among consumers in a Member State differs depending on whether one considers domestic, EU or non-EU purchases. Generally, considerably more respondents engaged in domestic online shopping than in cross-border shopping, both from EU and non-EU retailers. This is only different in Malta, Luxembourg and Cyprus, which can be explained by the small size of these countries. Cross-border online shopping from retailers located outside the EU is generally less popular than EU cross-border shopping, with the exceptions of

the United Kingdom, Iceland and Croatia. For the United Kingdom and Iceland, a high share of online purchases might be made from the United States.[30]

Member States where domestic online shopping is popular do not necessarily show high levels of cross-border online shopping as well. In Figure 4.1 the results have been sorted according to the percentage of consumers who made a cross-border online purchase within the EU. Luxembourg, Ireland, Malta, and Austria show the highest level of integration in the EU in respect of online shopping by consumers, with more than 30% reporting to have made a cross-border online purchase in the EU. The least integrated countries in terms of online consumer shopping are Romania, Poland, Hungary and the Czech Republic, where less than 7% of consumers purchased online from an EU retailer. This does not necessarily mean, however, that online shopping in general is unpopular, with percentages of 43% and 46% of consumers having engaged in domestic online shopping in Poland and the Czech Republic respectively. Countries where online shopping is less popular in general are, for example, Portugal and Greece, with less than 20% of respondents engaging in domestic online shopping, and less than 10% making purchases from EU and non-EU retailers.

Overall, the survey responses suggest that a high consumer interest in online shopping does not imply that these consumers are also willing to purchase from foreign (EU or non-EU) retailers. Put differently, Member States where consumers like to purchase goods and services online are not necessarily integrated in the EU in terms of online shopping. Conversely, Member States where many consumers engage in cross-border online shopping also show high rates of domestic online shopping - except for a few small countries.

i. The role of laws and institutions

The Flash Eurobarometer surveys included several approximations for the role that the applicable rules, as well as public institutions, play in consumers' choices

[30] The data cannot verify whether this is the case, as they do not provide information on the particular country where consumers shopped.

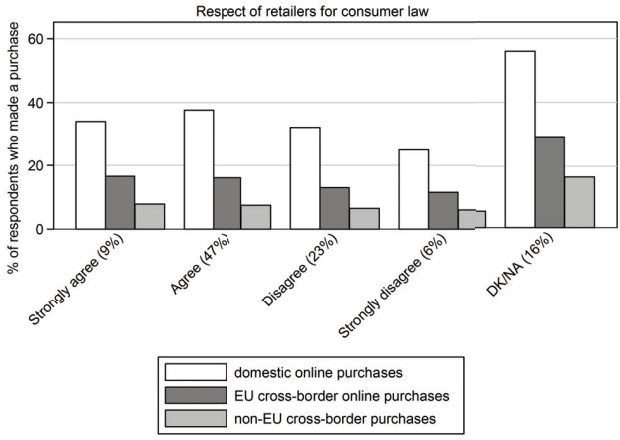


Figure 4.2: Online shopping by consumers' views of the respect of domestic retailers for consumer protection laws, average 2009-2014

to purchase goods online, and to purchase abroad.

Figure 4.2 shows the shares of consumers who made an online purchase, divided by their view of the respect of retailers in their country for consumer protection laws. Among the respondents who agree (or strongly agree) that retailers respect consumer protection laws, a higher percentage shops online than is the case for respondents who disagree, or strongly disagree, with this statement. Respondents were only asked about the respect for consumer law of retailers in their own country. Nevertheless, the percentage of respondents who shop online from an EU or non-EU retailer is slightly lower for respondents who do not think that retailers respect consumer law than for respondents who believe that they do. By far the highest percentage of online shoppers is found in the category of respondents who answered 'do not know' to the question of respect of retailers for consumer law.

While it is difficult to interpret the reasons for respondents to answer 'do not know', it might indicate that these respondents were not aware of the respect of retailers for consumer rules, and that they nevertheless shopped online - including from foreign retailers. A careful conclusion may be that while consumers who

believe that retailers respect consumer rules more often shop online than those who believe this is not the case, a considerable group of consumers shops online not knowing or not caring whether retailers respect consumer rules.

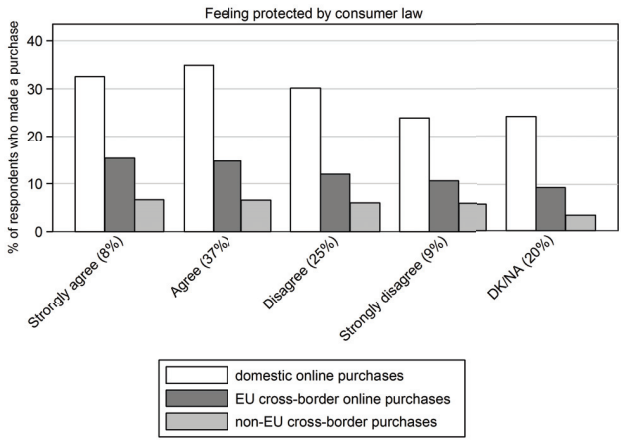


Figure 4.3: Online shopping by consumers' views on whether they feel protected by measures to protect consumers, average 2009-2014

Another aspect of consumers' attitudes towards rules and institutions is to what extent they feel protected by consumer laws and regulations. Figure 4.3 depicts the share of consumers who have made an online purchase in the past year, subdivided by their agreement with the statement that they feel adequately protected by existing measures to protect consumers. Consumers who feel adequately protected by consumer law show slightly higher rates of online shopping than consumers who do not feel protected. Among respondents who feel strongly that consumer law does not adequately protect them, a somewhat smaller percentage of respondents made a domestic online purchase than in the other groups. The same holds with respect to cross-border purchases within the EU, whereas the differences are negligible with respect to online shopping outside the EU. The higher levels of domestic and EU online shopping by respondents who feel protected by consumer law, as compared to those who do not, indicates that the perceived level of protec-

tion may affect consumers in their online shopping behaviour. Respondents who do not feel adequately protected by consumer rules are not only less likely to shop online from domestic retailers, but also from foreign EU retailers. A possible explanation could be that the perception of consumer protection may be relevant for consumers' willingness to shop cross-border. Nevertheless, the survey only asked the respondents whether they felt adequately protected by existing measures to protect consumers in general, without distinguishing between domestic rules and those applicable in other EU countries. Therefore, it could be the case that respondents who do not feel protected by consumer protection rules are simply more hesitant to shop online altogether. In this case, the question of whether consumer protection rules are fully harmonised throughout the EU may not be of relevance for these consumers' online shopping behaviour.

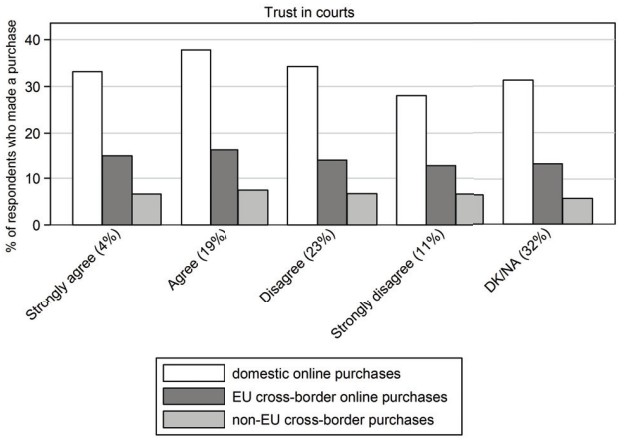


Figure 4.4: Online shopping by consumers' trust in courts, average 2009-2014

Consumers were not only asked about their perceptions of the level of consumer protection, but also its enforcement. If differences in enforcement are an obstacle for consumers to engage in cross-border shopping, one would expect to find lower rates of online shopping by respondents who reported that it was difficult to resolve disputes with retailers through courts and alternative dispute resolution

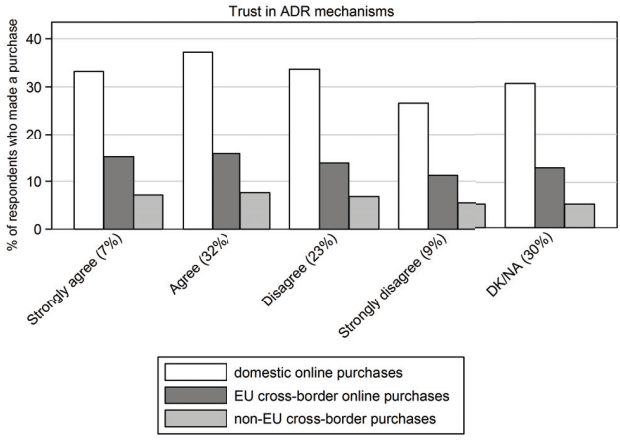


Figure 4.5: Online shopping by consumers' trust in alternative dispute resolution mechanisms, average 2009-2014

mechanisms.

Figure 4.4 and Figure 4.5 show online shopping, subdivided by consumers' attitudes regarding the ease with which they can resolve disputes with retailers through, respectively, the courts and alternative dispute resolution ('ADR') mechanisms. Both figures show lower rates of domestic online shopping among consumers who feel strongly that a dispute cannot be resolved easily through the courts or ADR mechanisms, than for those who felt (strongly) that they can rely on courts and ADR mechanisms. The differences are smaller for cross-border online shopping. Again, without knowing the reasons of respondents for their answers, a possible explanation might be that in relation to cross-border purchasers, consumers would not count on solutions by courts or ADR mechanisms, because other factors such as physical distance would preclude them from using these enforcement mechanisms.

Finally, Figure 4.6 and Figure 4.7 show rates of online shopping depending on consumers' trust in, respectively, public authorities and independent consumer organisations to protect their rights as a consumer. If consumer protection is a

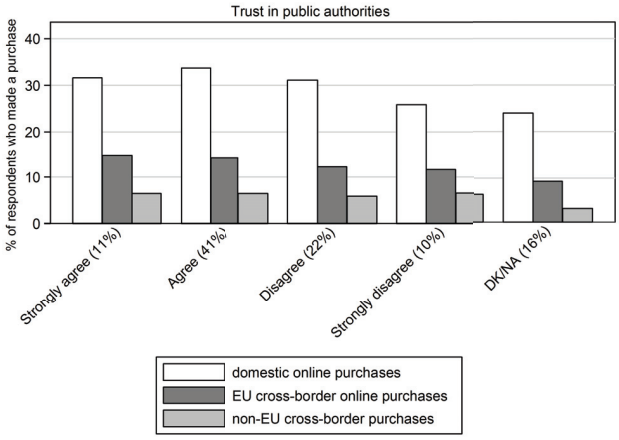


Figure 4.6: Online shopping by consumers' trust in public authorities, average 2009-2014

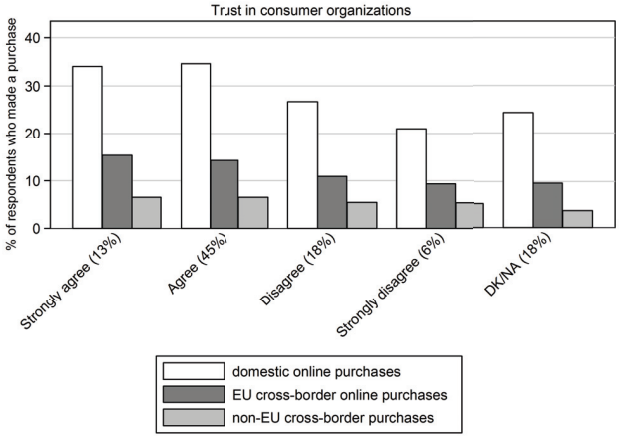


Figure 4.7: Online shopping by consumers' trust in consumer organisations, average 2009-2014

major factor in consumers' decisions to shop online and cross-border, one would expect to find higher percentages of online shopping among consumers reporting

a high level of trust in authorities than among those reporting a low level of trust. The responses depicted in Figure 4.6 do not show this, indicating that consumers' trust in public authorities might not be a very relevant factor for online shopping. Only the group of consumers who strongly feel that public authorities do not adequately protect their rights shows a lower percentage of online shopping as compared to the other groups of consumers.

Figure 4.7 on consumers' trust in independent consumer organisations shows a different picture. Rates of online shopping are considerably lower among consumers who do not believe in independent consumer organisations to protect their rights as compared to consumers who do. This holds for both domestic and EU online purchases, while the difference is small with respect to online purchases from retailers located outside the EU. This may imply that consumer trust in consumer organisations could be a relevant factor for online shopping, both domestically and abroad.

Summarising, these data indicate that consumers may be somewhat sensitive to rules and institutions for their online shopping behaviour in general. Nevertheless, what matters is whether these factors affect cross-border shopping as well. The above findings regarding the levels of online shopping indicate that consumers do not tend to be very sensitive to rules and institutions for their cross-border shopping behaviour. Consumers who feel protected by consumer law make cross-border online purchases slightly more often than those who do not. Such differences are not identified regarding consumers' trust in institutions, except in the case of consumer organisations.

ii. The role of demographic and social characteristics

Social and demographic factors may be more relevant for a consumer's interest in online shopping. Figure 4.8 shows the percentage of consumers who made an online purchase split by age group, where each age group includes approximately 20% of the respondents. The majority of respondents younger than 45 years old have made a domestic online purchase, with this share rapidly declining for older

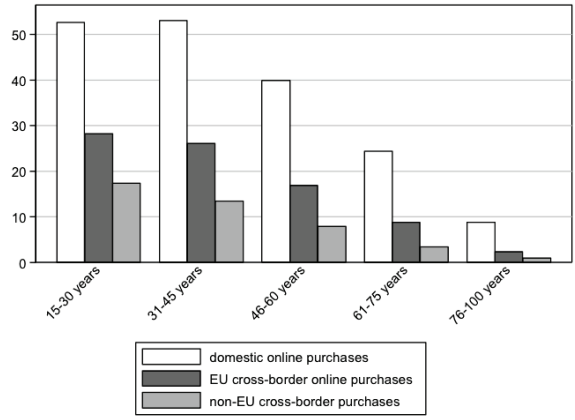


Figure 4.8: Online shopping by age group, average 2009-2014

respondents. A similar pattern exists for cross-border online purchases, both from EU and non-EU retailers. As Figure 4.8 illustrates, age appears to be a relevant factor for consumers' involvement in online shopping. With currently middle-aged respondents already shopping online, this could mean that rates of online shopping could increase considerably during the next years, not because of legal harmonisation but simply because of the familiarity of the younger generations with the Internet.

Another relevant factor for online shopping may be consumers' language knowledge, which may be correlated with consumers' education. If these factors matter for consumers' online and cross-border shopping behaviour, one would expect to find higher rates of online shopping among consumers with stronger language skills and more years of education. Figure 4.9 shows the percentage of consumers that has made an online purchase in the past year for groups of respondents with different language skills. As can be seen from Figure 4.9, the share of consumers who shop online is larger for respondents with some language knowledge than for those who can only comfortably use their mother tongue. Interestingly, consumers with some language knowledge do not only shop more from foreign retailers, but also from domestic retailers. However, Figure 4.9 does not indicate higher levels

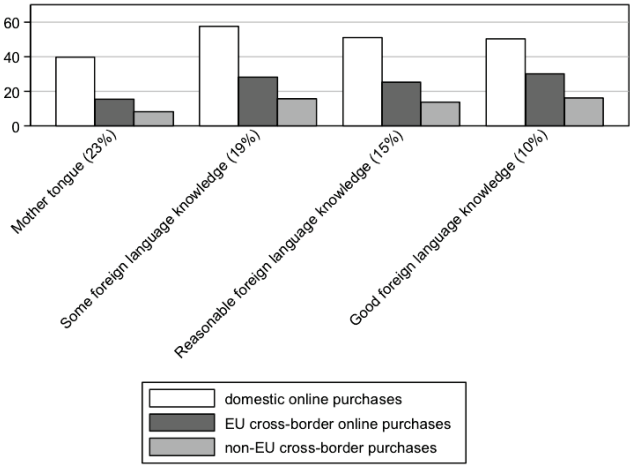


Figure 4.9: Language skills, average 2011, 2012 and 2014

of online shopping for additional language knowledge beyond this moderate level.

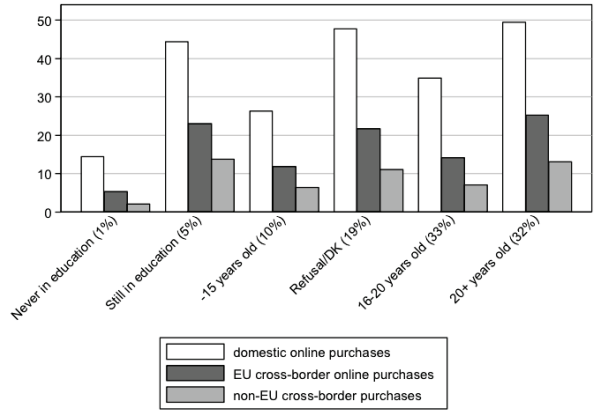


Figure 4.10: Online shopping by education, average 2009-2014

Figure 4.10 depicts the online shopping of respondents with different levels of education. In the groups of respondents who were in education until they were over

20 years old, and those who are still studying, a considerably larger share shops online than in the groups of respondents with little or no education. Overall, an increasing share of respondents engages in domestic online shopping as respondents have had a longer education. Regarding cross-border online shopping, a difference is only visible between, on the one hand, groups with no education or little education (until the age of 15), and on the other, groups with a long education (beyond the age of 20, or still in education). Overall, Figure 4.10 indicates that education is a relevant factor regarding online shopping by consumers.[31] The additional language knowledge that may be acquired in longer education could be an explanation for this finding. Another explanation might be that respondents in these groups have on average higher income levels, although this does not flow from the surveys, which did not ask the respondents' about their income.

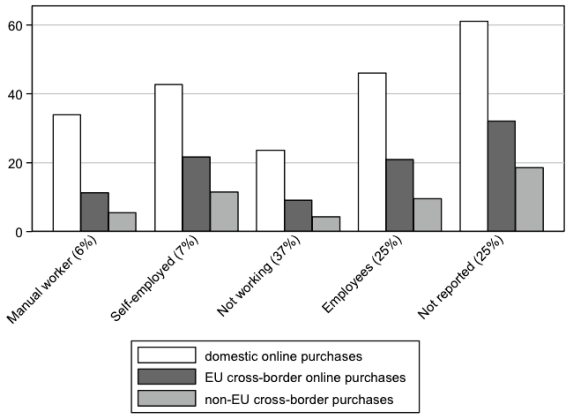


Figure 4.11: Online shopping by occupation, average 2009-2014

Figure 4.11 shows the rates of online shopping among respondents with different occupations. As Figure 4.11 shows, among working consumers a larger share engages in cross-border shopping than among non-working consumers. Although the data do not provide information on the financial situation of non-working

[31] A considerable share of respondents did not report their level of education ('Refusal/DK'). Nevertheless, this group also reported high levels of online shopping.

respondents, income may be a reason for this result. The group of non-working consumers includes, besides unemployed consumers, students and pensioners. As Figure 4.8 above demonstrated, respondents above 45 years old shop online considerably less than younger respondents. Table A.4 in the Appendix shows how each age group is represented in the various occupations. With more than half of the non-working respondents being older than 61, the low rate of online shopping in the group of non-working consumers can be explained by the relatively high age of the respondents in this group. Figure 4.11 also shows that among self-employed consumers and employees, a higher share shops online than among manual workers. The difference is particularly large with respect to online shopping from EU retailers. The rates of online shopping are by far the highest among respondents who did not report their occupation. As Table A.4 in the Appendix shows, respondents who did not report their occupation are relatively young as compared to the overall group of respondents. This may explain the finding for high levels of online shopping in this group. Another explanation could be the level of education of respondents who did not report their occupation. As Table A.5 illustrates, the group of respondents that did not report their occupation contain a relatively high number of students (choosing the category 'still in education'), as well as respondents with more than 16, or even more than 20 years of education. As Figure 4.10 above illustrated, those with a higher education level tend to shop more online and more abroad, potentially thanks to stronger language skills.

Summarising the findings of this empirical overview, it appears that the levels of online shopping differ only somewhat depending on the respondents' perceptions of the strength of consumer protection rules, and the differences are particularly small when considering online shopping from foreign retailers. The most clear differences in online shopping are found when comparing respondents with different demographic and social characteristics. With respect to the respondents' trust in courts, ADR mechanisms and public authorities, no different levels of online shopping were found, whereas respondents with more trust in independent consumer organisation do show somewhat higher levels of online shopping. While these findings do not directly answer the question of whether differences in consumer

protection rules currently hamper cross-border shopping, they do indicate that the applicable consumer rules may not be a crucial aspect for consumers in deciding whether or not to shop abroad. This sheds doubt on the hypothesis found in the Consumer Rights Directive, that fully harmonising consumer protection rules would result in more cross-border shopping by consumers.

These findings add to the findings of Hubbard (2013), that the surveys only ambiguously support the claims that fragmentation in contract law present barriers to cross-border trade for small-and medium-sized enterprises and consumers. According to Hubbard's analysis of the surveys, it does not become clear that a large number of traders would be discouraged from cross-border activity due to obstacles created by differences in contract law. Neither do the surveys provide strong evidence that contract law is the primary obstacle to cross-border trade. The empirical overview presented above adds to Hubbard's findings by focusing on the relevance of the applicable rules for consumers, finding that consumers do not appear to be particularly sensitive to rules and institutions for their cross-border online shopping behaviour. Instead, demographic and social factors, illustrating practical obstacles such as differences in language, may be more relevant for consumers' cross-border shopping behaviour.

These findings also support the results found in a vignette study conducted by Thommes et al. (2015) in 2015. In this study, individuals from Belgium, Germany and the Netherlands were confronted with consumer choices with varying price, location, language and legal issues governed by EU law, such as cancellation rights and guarantees. The authors found that legal rules have a limited influence on buying decisions, and other factors such as language seem to play the most important role.

4.4 Conclusion

This chapter has evaluated the desirability of harmonisation in the presence of heterogeneous preferences for rules, and applied the findings to full harmonisation

in the area of consumer law. Building upon the previous chapter, which concluded that not only transaction costs but also compliance costs should be taken into account when considering the costs and benefits of harmonisation for the internal market, this chapter illustrated that also the heterogeneous preferences of citizens (in this case, consumers) should be taken into consideration. Analysing recent harmonisation initiatives in the field of consumer protection, the chapter found that the EU legislator nevertheless tends to limit its focus on transaction costs. In this area of law, harmonisation is generally based on the legislative competence to improve the internal market, meaning that EU legislative initiatives must contribute to the functioning of the internal market by removing barriers for consumers to cross-border shopping. The focus of legislative instruments for consumer protection is therefore generally on reducing transaction costs faced by consumers and sellers due to differences in the applicable rules. Based on this argument, the Commission has initiated several full harmonisation initiatives.

Using a vertical differentiation model, the chapter has illustrated the ambiguous welfare effects of harmonising rules when consumers have different preferences for these rules. Harmonisation has two opposing effects on welfare. On the one hand, harmonisation may have a *price effect*: prices may go down if harmonisation reduces transaction costs, allowing firms to sell their products abroad, thereby enhancing competition. On the other hand, harmonisation causes a *quality differentiation effect*: by forcing the legal rules closer together, consumers enjoy less variety in legal rules. If, for example, a consumer preferred a cheap product with low consumer protection, and harmonisation forces the consumer protection standard upward, this consumer is no longer able to purchase his preferred product. Whether harmonisation increases welfare, therefore, depends on i) the initial differences between countries' preferences for legal rules, and ii) the beneficial effects of harmonisation on reducing transaction costs. Consequently, the model illustrates that harmonising rules involves a trade-off between enhancing competition on the one hand, and ensuring that policy corresponds to local preferences on the other. Harmonisation is most likely to be welfare improving if the beneficial effects on competition are sufficiently large, and the differences in preferences for

rules are sufficiently small.

Nevertheless, the scholarly debate on full harmonisation of consumer protection rules highlighted that preferences for consumer protection may vary across Member States, and the empirical overview presented in this chapter, as well as other empirical studies, suggest that differences in consumer protection rules may not actually constitute the main obstacle for consumers and firms when transacting abroad. Cross-border shopping behaviour differs somewhat, but not considerably between groups of respondents that feel differently about the level of protection offered by consumer protection rules, the degree to which these rules are being respected by retailers and the ease with which they can be enforced in court or by means of alternative dispute resolution mechanisms. More clear differences in the levels of online shopping are found when comparing respondents with different demographic and social characteristics, such as age, education and language skills. These findings, while not directly answering the question of whether differences in rules form an obstacle to the internal market for consumers, suggest that not the applicable rules, but other, practical aspects may be the main deciding factor for consumers' cross-border shopping behaviour.

Despite these findings, and the scholarly critique on full harmonisation in the 2011 Consumer Rights Directive, the European Commission again pursues full harmonisation in the 2015 proposals for Directives on digital contracts for goods and online content. In light of the findings of this chapter, this does not appear as an entirely desirable development.

Chapter 5

Piecemeal Harmonisation of European Private Law: The Case of Limitation Periods in the Antitrust Damages Directive[1]

The previous chapters studied the considerations involved in determining whether harmonisation to improve the internal market is desirable, and applied the legal and economic arguments to full harmonisation in the area of consumer protection. As was discussed, a particular aspect of the recent EU initiatives in consumer law is that they are based on a dual legal basis, pursuing both a high level of consumer protection and the completion of the internal market.

The current and next chapters focus on a different area of EU policy, private antitrust enforcement, which similarly to consumer policy has a dual legal basis, including the legislative competence for the internal market. In 2014, the Directive

[1] An article based on this chapter has been published under the title 'Piecemeal Harmonisation of European Private Law: The case of Limitation Periods in the Antitrust Damages Directive' in the *Hungarian Yearbook of International Law and European Law*, Marcel Szabó, Petra Lea Láncos en Réka Varga (eds.) Eleven International Publishing 2016.

on antitrust damages actions ('the Directive') was adopted, which aims to provide a 'level playing field' for antitrust damages actions by stipulating minimum rules throughout the EU, and to ensure full compensation of antitrust harm.[2] The current and next chapter critically examine whether these objectives are likely to be achieved by this Directive, and whether harmonisation in this field is desirable in light of the Law and Economics framework presented in the previous chapters. Chapter 6 highlights a difficulty in the interplay between the substantive rules in the Directive and their enforcement: the tension between private enforcement and the leniency program, which forms an essential part of public enforcement of competition law.

The current chapter addresses the question of whether the Directive succeeds at creating a level playing field for damages actions in the EU, focusing on the example of limitation periods. The chapter considers whether specific rules for antitrust damages actions are desirable. The chapter is structured as follows. Section 5.1 provides an overview of the debate regarding the harmonisation of civil procedural law. Section 5.2 discusses the rationale for limitation periods in general as well as the particular issues that arise in the context of limitation periods for antitrust damages claims. Section 5.3 presents a comparative overview of the applicable rules on limitation periods in the Member States, followed by an investigation of the impact of the Directive. This section also discusses the possible ways for Member States to implement the Directive, as well as unclear terms and rules that are not dealt with by the Directive, which may result in remaining differences in the rules. Section 5.4 concludes.

[2] Directive 2014/104/EU of the European Parliament and of the Council of 26 November 2014 on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union ('Antitrust Damages Directive') O.J. 2014 L 349/1.

5.1 Introduction

The Antitrust Damages Directive provides a common set of rules for antitrust damages claims in the EU. The Directive sets minimum standards regarding, for example, the burden of proof, access to documents, joint and several liability and damages quantification. The Directive has a twofold aim: to ensure full compensation for victims of competition law infringements, and to optimise the interaction between public and private enforcement of competition law.[3]

Similarly to the Consumer Rights Directive, this Directive has a dual legal basis: it is based on Article 103, on competition law matters, and Article 114 TFEU, on improving the internal market. The Directive pursues full compensation of antitrust harm by encouraging private damages actions, and aims to improve the functioning of the internal market by preventing that claimants face varying rules across Member States.[4] The Antitrust Damages Directive notes that '[i]t is necessary to ensure a more level playing field for undertakings operating in the internal market and to improve the conditions for injured parties, in particular citizens and small businesses, to make use of the rights they derive from the internal market.'[5] The Directive continues that in order to increase legal certainty and reduce the differences between Member States' rules on actions for damages, 'certain relevant key rules' need to be harmonised in order to avoid divergence of applicable rules, and prevent distortions on the internal market.[6]

The internal market argument in the Directive can thus be summarised as follows: i) diverging rules lead to an uneven playing field, which may jeopardise the proper functioning of the internal market, and ii) diverging rules may affect claimants' decision about where to file their claims, leading to uneven enforcement for undertakings depending on their place of establishment, and ultimately affecting

3 Directive, Preamble para. 54; Proposed Directive, pp. 2-5.

4 Preamble para. 54 of the Directive; Proposal for a Directive of the European Parliament and of the Council on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union, COM(2013) 404 final, pp. 2-5.

5 Antitrust Damages Directive, Preamble para. 55.

6 Antitrust Damages Directive, Preamble para. 55.

market competition.

The Directive affects only antitrust damages claims, leaving the rules regarding all other types of damages claims unaffected. This can be called 'piecemeal harmonisation': harmonisation with a limited scope or topic, resulting in harmonisation of only parts of national civil and procedural law. The primary reason for this harmonisation approach is that the EU legislative competences are structured according to a functionalist paradigm. The competences do not reflect the distinction between public and private law that is typically found in national legal orders (Mańko, 2015). Critical commentators have emphasised the risk that the piecemeal harmonisation approach leads to fragmentation of civil procedural law in the Member States. At the same time, harmonisation of civil and procedural law in its entirety has also been subject of heavy debate: proponents consider it necessary for the functioning of the internal market, while others oppose harmonisation in this area of law altogether, as it would form part of Member States' legal culture and identity.[7]

This chapter considers the rules on limitation periods in the Directive in light of this critique, and against the background of the Directive's goal to create a level playing field for rules on antitrust damages claims. The chapter also evaluates the design of the rules on limitation periods in the Directive. A new comparative overview was compiled on the basis of Member States' laws, policy documents and country reports, laying out the current differences in limitation periods across Member States and assessing the impact of the Directive.

The reason to focus on limitation periods is twofold. On the one hand, the length of limitation periods allows for a relatively straightforward comparison of rules across Member States, allowing us to grasp the impact of harmonisation. On the other, limitation periods are embedded in Member States' systems of civil (or procedural) law, and are relevant in the context of any type of damages claim. It therefore provides a good example to study the impact of piecemeal harmonisation, as compared to a comprehensive approach to harmonisation of civil and

[7] See section 5.1.1 below.

procedural law.

The chapter concludes that, although the Directive considerably reduces the variation in limitation periods of the Member States, it nevertheless fails to create a level playing field due to three main reasons. First, Member States may choose to implement the Directive in different ways, which is indeed what has happened. Secondly, a number of unclear terms in the Directive leave room for interpretation, adding a second source of possible variation across Member States. Finally, the rules in the Directive do not cover all aspects of limitation periods, so that differences in rules will remain.

5.1.1 The debate on harmonising civil procedural law

The harmonisation of civil procedural law is a controversial theme, and has been discussed for a long time as part of the general debate on the desirability of harmonisation of private law.[8] Historically, procedure was viewed by many as too closely linked to a nation's identity for it to adapt to a foreign model. As European integration progressed, harmonisation of civil procedure remained a debated issue. While some perceive a uniform procedure as a contribution to market integration or to the ideal of a European polity, more sceptical observers have questioned the need for full harmonisation.

In 1990 the Commission requested a group of experts chaired by Professor Marcel Storme to study the harmonisation of procedural laws. Their report, published in 1994, proposed an EU directive to harmonise core parts of the civil procedures of the Member States. Harmonisation could proceed on a piecemeal basis, and several issues were identified where common EU rules could be introduced (Storme, 1994). The report divided opinion and triggered a debate on the desirability of

[8] Whether limitation periods are considered part of procedural law or of substantive law differs per jurisdiction. However, the arguments raised in the debate on the harmonisation of procedural law appear relevant in the context of limitation periods, regardless of their qualification. See on the relation between harmonising civil procedural rules and substantive rules also Kerameus (2011). On the harmonisation of private law in the EU see e.g. Schmid (2002).

civil procedural harmonisation in the European Union.[9]

From a legal perspective, various reasons have been brought forward for why harmonisation and even unification of civil procedural law may be required.[10] First, differences in the procedural rules of the Member States can disrupt the smooth functioning of the internal market and cross-border trade.[11] Differences in procedural law may moreover contribute to a fragmented market and not to the creation of a single internal market (Van Rhee, 2012, 50). Differences in legal rules between Member States could also create inequality in the competitive conditions. Harmonisation of civil rules affecting enforcement could secure a level playing field for undertakings, and thus ensure the functioning of the unified substantive rules (Kerameus, 2011, 121; Storme, 1994, 44-45).

A second reason why harmonisation may be required is because differences in procedural rules may affect access to justice across European Member States (Storskrubb, 2008, 78). When EU law creates rights and obligations with direct effect, the realisation of these rights and obligations relies on their enforcement in national courts. Existing national procedural rules might limit the realisation of such substantive EU norms. Variation in these rules furthermore means that litigants are treated unequally in different national jurisdictions, e.g. on questions of standing, time limits, or burden of proof. Harmonisation of procedural rules may thus be needed to ensure a uniform application of EU law (Storskrubb, 2008, 2).

A third argument for harmonising civil procedural rules may be to foster transparency and legal certainty (Eliantonio, 2009, 6-7). In comparison to the ad-hoc, case-by-case harmonisation that is currently being developed by the Court of Justice of the EU, a legislative measure, adopted on the basis of democratic procedures, is argued to be more legitimate (Eliantonio, 2009, 11).

[9] Critical responses can be found in e.g. Van Rhee (2012, 56), Lindblom (1997, 32-45), Himsworth (1997, 303) and Juenger (1997, 932).

[10] See for legal views on civil procedural harmonisation generally e.g. Gottwald (2005), Storme (2005), Storskrubb (2009), Van der Grinten (2007), Uzelac (2012) and Wagner (2012).

[11] C.f. Schwartze (2000, 138-141), who analyses the costs of market integration under varying procedural rules.

Finally, harmonisation of procedural laws has been argued to be a necessary step in the process of integration, in parallel with the growing Europeanisation of substantive laws. EU law influences procedural laws of the Member States in several ways - for example via Article 81 TFEU, which empowers the EU to enact legislation in order to improve and guarantee effective access to justice and to improve the functioning of civil proceedings, and via the judgements of the CJEU. Some therefore see a compelling need for an umbrella instrument, providing for a coherent and systematic set of rules of European procedural law (Hess, 2012, 168-171).

Various legal arguments against harmonisation of civil procedural law have been advanced as well. Some have questioned whether a European procedural law would fit into the legal traditions of the Member States (Lindblom, 1997, 27; Biavati, 2001, 91). Some consider these legal traditions to represent a core part of Member States' culture, maintaining that harmonisation would be contrary to the principle of subsidiarity (Collins, 1995, 353). Arguably, procedural rules, despite their technical nature, enforce a political choice that should not be harmonised. Instead, the legal plurality should be maintained (Storskrubb, 2008, 21).[12] National tradition may also form a more technical obstacle to harmonisation because civil procedure is embedded in a national structure for the administration of justice, which is organised differently from state to state (Allemeersch and Vandensande, 2012, 327). Harmonisation could prove particularly challenging because of the close links between procedural law and substantive law of the different Member States (Visscher, 2012, 84). In this light, some commentators have questioned whether market integration is an appropriate starting point to harmonise procedural law, at the heart of which lie other values besides efficiency (Storskrubb, 2008, 23; Niemi-Kiesiläinen, 1999, 251). Harmonisation has also been dismissed for the risk of resulting in a rigid and inflexible system (Schwarze, 2000, 177), and because it would be extremely hard to design a set of rules that all Member States would agree upon, given that their legal systems are based on such different principles (Eliantonio, 2009, 9).

[12] Storskrubb refers to Legrand (1997, 61) and Prechal (2001, 55-58).

5.1.2 Economic considerations in harmonising civil procedural law

The economic considerations in harmonising civil procedural law can, as before, be found in the economics of federalism literature.

Heterogeneous preferences

As was discussed in the previous chapters, from an economic perspective legal diversity is in principle desirable because people may have different preferences regarding the applicable rules. A harmonised, European law is not able to take these differences into account.

While civil procedural law may not be a typical salient policy issue, the Member States do have deeply rooted civil law traditions, as was mentioned above. Since harmonisation would eliminate the possibility for Member States to tailor their civil procedural rules to their preferences, harmonisation would have to offer advantages or solve problems of a decentralised system in order to justify it.

Dynamic effects

The need to justify harmonisation is even stronger since legal diversity offers additional advantages beyond matching varying preferences. A plurality of systems offers the possibility to experiment with different legal solutions, and for jurisdictions to learn from the experiences of other jurisdictions.[13] In the context of procedural law, forum shopping by consumers may even provide an incentive for improvement of the system (Lindblom, 1997, 23; Legrand, 2002, 68).

At the same time, harmonisation may be a way to avoid a 'race to the bottom', in which states continuously relax their standards in order to attract actors to their jurisdiction, while it would be in the interests of all jurisdictions not to lower them beyond a certain point (Wagner, 2002, 1003-1004; Ogus, 1999, 415).

[13] See in the context of procedural law e.g. Zuckerman (2002, 322) and Andrews (2008, 281).

However, this problem appears minor in the context of procedural law, where the costs and benefits of attracting claimants are not straightforward.[14] It is moreover unlikely that the applicable procedural rules would be reason for any citizen or firm to relocate.

Externalities

Harmonisation may be warranted if the costs of a regulation can be (partly) externalised to other jurisdictions, and lower-level legislators fail to take these costs into account in choosing their policies. Harmonisation may then ensure that the central legislator designs a policy that takes into account all of its benefits and costs. However, such interstate externalities do not play a major role in procedural law, given that civil procedure takes place between the parties involved (Visscher, 2012, 80-87).

Transaction cost savings

Finally, harmonisation may be desirable in order to achieve economies of scale or to reduce the previously mentioned transaction costs. Scale economies exist if a central legislator can design and implement a policy at lower costs for a given area than each of the lower levels of government combined. Given that each Member State has developed its own procedural rules, this does not appear to be the case for the harmonisation of procedural law. Indeed, harmonisation may reduce transaction costs involved in having to become familiar with all the different legal systems, although only to the extent that harmonisation can really achieve uniformity. This may be doubtful considering the remaining differences in the underlying substantial law, language and interpretation (Visscher, 2012, 87). Therefore, harmonised rules may not result in more legal certainty. Moreover, there is no empirical evidence that harmonisation of law would result in more

[14] On the one hand claims burden the public system, while on the other some types of claims can attract business in the form of law firms.

international transactions (Visscher, 2012, 76; Smits, 2005, 179). Harmonisation could reduce transaction costs resulting from differences in legal systems that make international transactions more costly, such as costs of becoming informed about relevant foreign rules or of drafting multiple contracts or terms and conditions. Nevertheless, the savings in transaction costs from harmonisation may be limited given the costs associated with translation and interpretation of the unified law (Visscher, 2012, 83-84). Furthermore, it is doubtful whether harmonisation would create a level playing field, since unequal competitive conditions across Member States would remain if foreign actors have to comply with different substantive norms. Even if the law is harmonised, other aspects such as infrastructure and wages will continue to differ (Visscher, 2012, 76).

In sum, the arguments in favour of harmonisation of procedural law appear to be few. And in practice, so far a comprehensive approach to harmonising procedural law in the EU, as was suggested by Storme, has not been taken up. Nevertheless, EU law influences national procedural law in various ways, using different modes and forms of harmonising specific aspects of procedural law.

5.1.3 Different ways to harmonise

The Treaty of Amsterdam introduced judicial cooperation in civil matters as a specific EU policy area, now included as Article 81 TFEU, which empowers the EU to enact legislation in order to improve and guarantee effective access to justice and to eliminate obstacles to the proper functioning of civil proceedings. Moreover, the Court of Justice has on numerous occasions intervened in national procedural rules. The Court has set minimum standards and reference points by using the tools of equivalence and effectiveness, in order to ensure a minimum degree of uniformity (Eliantonio, 2009, 1). This has spurred a debate regarding the question whether Member States still have procedural autonomy at all (Storskrubb, 2008, 14-20). Parallel to these developments, the EU legislator adopted several substantive instruments for specific legal areas that, in practice, extend into other fields

such as procedural law as well. An example is the Enforcement Directive[15] which applies to litigation pertaining to Intellectual Property rights infringements. The European Commission proposed an extension of the core concepts of this Directive to additional areas of EU law, such as collective redress in cartel and consumer protection law (Hess, 2012, 165; Storskrubb, 2008, 26). Given these developments in European law, the relevant question may be not so much whether we should harmonise or not, but what would be the best approach to do so (Allemeersch and Vandensande, 2012, 326). In searching for a model for procedural harmonisation, it is necessary to consider what the end result should be, as well as what type of harmonisation would be possible and manageable.

A comprehensive approach, in which all procedural law is fully harmonised, would preserve the coherence and the transparency of the legal system (Hess, 2012, 165; Storskrubb, 2008, 284). However, it may not be sensible to harmonise procedural law in areas where substantive law is not harmonised, since the conditions to effectuate a claim in these areas will still differ across Member States (Visscher, 2012, 85). It is moreover doubtful that such an approach would be politically attainable, which is likely to be one of the reasons for the European Commission to have taken a different approach. For all the reasons discussed, many commentators consider unification of procedural law to be undesirable, but welcome less far-reaching European projects in this area (Storskrubb, 2008, 24).

An alternative approach, taken up in Article 81 TFEU on cooperation in civil proceedings, is to limit harmonisation to transnational disputes.[16] Article 81 TFEU provides for harmonisation of laws in civil matters with a cross-border element, and has resulted in a number of European legislations.[17] The limitation

[15] Directive 2004/48/EC of the European Parliament and of the Council of 29 April 2004 on the enforcement of intellectual property rights, OJ 2004 L 195/16 et seq ('Enforcement Directive').

[16] This approach was already suggested by Juenger (1997, 936).

[17] E.g. Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings; Council Regulation (EC) No. 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters; and Regulation (EC) No. 805/2004 of the European Parliament and of the Council of 21 April 2004, creating a European Enforcement Order for uncontested claims.

to cross-border cases means that purely national cases continue to be governed by the civil procedural rules of the Member States. The problem is that this creates double standards of protection, which may give national courts a hard time in maintaining the integrity of the system. According to Wagner, the limitation to cross-border cases in Article 81 TFEU is not based on any logic and takes out much of the practical relevance of the legislation (Wagner, 2012, 98). It may also be impossible to sever the parts of the claim that are based upon EU law from those that are rooted in national law (Eliantonio, 2009, 8). Van Rhee even maintains that differences between the procedural laws of the Member States always have cross-border implications, for example on the decisions of businesses about where to produce and sell their products (Van Rhee, 2012, 54).

The limitations to full harmonisation and to Article 81 TFEU can explain, at least in part, the exploration of harmonisation initiatives with a limited scope in the area of civil procedure, also referred to as vertical harmonisation. Vertical harmonisation means that the EU introduces procedural rules without relying on Article 81 TFEU as a legal basis, but instead relying on a legislative competence for a specific area of law (Wagner, 2012, 101). Examples of vertical harmonisation initiatives with a procedural law element include consumer policy[18] and the Enforcement Directive discussed above.[19] The Enforcement Directive was adopted on the basis of Article 114 TFEU concerning the functioning of the internal market. Similarly, the Antitrust Damages Directive was adopted on the basis of Article 114 TFEU, in conjunction with Article 103 TFEU on the enforcement of competition law. By contrast, a horizontal instrument, relying on Article 81 TFEU, could include civil procedural rules that apply across the board rather than for one area of law.

In short, currently a 'piecemeal' approach is attempted for harmonising procedural law, rather than a systemic, comprehensive approach. This means that unified procedural rules have to coexist with national rules. This coexistence of rules can be considered as a characteristic of the relationship between EU law and national

[18] For examples see Kennett (2000, 40).
[19] Enforcement Directive, footnote 15.

law, and inherent in the constraints and limitations that accompany European integration (Kerameus, 2011, 156).

However, the problem with a 'piecemeal' harmonisation approach is that various special rules are created that may undermine the internal coherence of national procedural law. Moreover, the harmonised rules might not cover all aspects of a civil (procedural) law topic, resulting in remaining differences that defeat the purpose of harmonisation. The special rules on limitation periods for antitrust damages claims laid down in the Antitrust Damages Directive are an example of where this problem of fragmentation of procedural law may occur. This raises the question of the rationale for harmonised rules on limitation periods, and the likely impact of harmonisation in the Member States. We therefore consider this in more detail in the next sections.

5.2 Limitation periods

5.2.1 The efforts to encourage antitrust damages claims

In the European Union, antitrust enforcement has so far primarily relied on public enforcement by competition authorities. The number of private damages actions has increased considerably, particularly in the United Kingdom, Germany and the Netherlands during the last years, but private damages actions still play a limited role in the EU as compared to the United States.[20] The European Commission introduced the Antitrust Damages Directive aiming to encourage claimants to file antitrust damages actions.[21]

The efforts towards the adoption of this Directive started with the Ashurst study, which was requested by the Commission with the aim of identifying the legal

[20] For an overview of recent cases in the United Kingdom, Germany and the Netherlands see e.g. Kuijpers et al. (2015, 1). As a comparison, until 2004 only 60 damages actions were reported in the EU, compared to almost 700 cases in the U.S. in only two years. See also Scharaw (2014, 356) and Ginsburg (2005, 435).

[21] Preamble paragraph 54 of the Directive; Proposed Directive, pp. 2-5.

and practical obstacles faced by parties to antitrust damages actions. The report concluded that private enforcement in the EU showed 'total underdevelopment', and Member States' rules were of an 'astonishing diversity'. The Ashurst report identified legal rules and their diversity across Member States as obstacles for potential antitrust claimants (Waelbroeck et al., 2004, 1). The Ashurst report also found that rules on limitation periods differed markedly across Member States, leading to uncertainty among litigants and possibly to the denial of compensation for antitrust harm.

Several cases illustrate the importance of limitation periods in the context of antitrust damages claims, where it may take years for claimants to learn about the particularly harmful conduct. In 2007, the Rotterdam District Court found a claim brought by an electro-technical fittings distributor against the association of producers of fittings to be time-barred.[22] In 2014, the British Supreme Court dismissed an antitrust damages claim by Deutsche Bahn against carbon manufacturer Morgan Crucible, because the action was brought out of time.[23] Later that year, a London court struck out around thirty years of potential damages from a lawsuit brought by a group of British retailers against Visa because the limitation period had run out.[24]

With the aim of protecting the interests of claimants and defendants, the Directive lays down specific rules for limitation periods in antitrust damages actions.[25] The Directive stipulates that the limitation period starts when the infringement of competition law has ended and the claimant knows, or can reasonably be expected to know of i) the defendant's behaviour and the fact that it constitutes an infringement of competition law; ii) the fact that the infringement of competition law caused harm to him; and iii) the identity of the infringer (Article 10(2) of the Directive). The minimum duration of the limitation period is five years (Article 10(3)). Member States must moreover ensure that limitation pe-

22 Rotterdam District Court 7 March 2007, LJN BA0926.

23 *Deutsche Bahn AG and others v Morgan Crucible Company plc* [2014] UKSC 24.

24 *Arcadia Group Brands et al v Visa et al*, 2013-985.

25 For a discussion of the contents of the Directive, see e.g. Wisking et al. (2014) and Editorial (2014).

riods are suspended during proceedings at the national competition authority or the Commission, and until at the earliest one year after the infringement decision has become final or after the proceedings are otherwise terminated (Article 10(4)). The limitation period must moreover be suspended for the duration of a consensual dispute resolution process (Article 18(1-2)). Member States retain the right to maintain or introduce general, absolute limitation periods, provided that their duration does not render it impossible or excessively difficult for claimants to obtain compensation.[26]

5.2.2 The rationale for a European limitation period for antitrust damages claims

The rationale of introducing a uniform limitation period for antitrust damages claims includes various considerations. The first concerns the general question of the optimal length of a limitation period for civil claims, and the second concerns the question whether antitrust damages claims possess special characteristics that warrant specific rules for the limitation period.

The Length of the Limitation Period

The legal rationale of limiting the period during which an injured party can file his claim is to provide the defendant with legal certainty. The limitation period allows a defendant to 'close the books', which has an efficiency benefit: it allows a defendant to use the resources reserved for possible claims in a more productive way (Martin, 1981). From an economic perspective, it could be said that limitation periods are efficient since the major contribution of tort law to efficiency in the aspects of deterrence and perceptions of fairness can be attained under relatively short time limits, and that longer time limits contribute only marginally in these regards (Gilead, 2008). Another argument in favour of limitation periods is that evidence deteriorates over time. When claims are filed long after the occurrence

[26] Preamble, Para. 36 of the Directive.

of the damage, trials become more costly and legal error becomes more likely (Cooter and Ulen, 1988, 155; Landes and Posner, 1987, 567;).

A limitation period that is too short, however, may lead to a denial of compensation for victims (Renda et al., 2007, 533). In addition, the time barring of claims limits injurers' exposure to liability, thereby reducing their incentives to comply with the law ex ante. Defining the optimal duration of the limitation period therefore involves a balancing exercise. The optimal duration is found at the point where marginal costs of limiting claims, i.e. the reduction in deterrence, equals the marginal benefits of doing so, i.e. error costs and the social costs of litigation (Miceli, 2000).

Nevertheless, finding this optimal length of limitation period is a complex task, given the various relevant aspects that are involved. In addition to deterrence, litigation costs and the costs of preserving evidence, the length of the limitation period may also have a bearing on litigation dynamics. A shorter limitation period may induce claimants to invest more resources in obtaining evidence in order to avoid the time bar. Claimants may also have lower bargaining power if the settlement negotiation takes place closer to the time limit. Additionally, defendants may adopt strategic behaviour to induce claimants to postpone bringing claims (Renda et al., 2007, 535).

A Special Limitation Period for Antitrust Damages Claims

Arguments can be brought forward for why additional considerations are at play in the context of antitrust damages actions that warrant special rules on limitation periods. First, claimants may take a long time to find out about antitrust harm, since firms that exert anti-competitive behaviour usually expend considerable resources in keeping this conduct a secret. Moreover, claimants may only learn about the harm they suffered after a competition authority has launched an investigation, or even when the firms have been sanctioned for their anti-competitive conduct. Such investigations and proceedings can take several years, meaning that for follow-on civil damages claims the limitation period may need to be linked to

the length of public proceedings.[27] Finally, in the case of cartels, antitrust damages claims affect the incentives for cartel participants to reveal the cartel under the leniency program.[28] Protecting the interests of leniency applicants, in order to maintain effective public antitrust enforcement, while allowing for compensation of antitrust harm, may have implications for the desirable limitation period.

Nevertheless, the general argument that piecemeal harmonisation might undermine the internal coherence of Member States' legal systems also applies to antitrust damages claims. Member States have set a limitation period according to domestic legal traditions and in conjunction with standards of care and procedural conditions for bringing a claim. Introducing a special limitation period for antitrust damages actions does not take these additional rules into account.

The design of the rules on limitation periods in the Directive spurred critical responses.[29] The additional grace period of one year has been criticised for putting a penalty on appealing the decision of the Commission or the competition authority. As a result of the grace period, appealing extends the period during which a defendant is exposed to claims (Kortmann and Swaak, 2009, 348). The additional grace period may create incentives to appeal the public decision, even for the firm whose fine was waived under the leniency program. Since claimants usually wait to file their claim until the decision has become final, defendants can postpone claims by appealing in order to avoid being the primary target for litigation (Akman, 2014, 390-392; Howard, 2014). The Directive amplifies the reasons for defendants to avoid being the primary target, by allowing claimants to collect all their damages from one defendant. This defendant subsequently has to collect contributions from the other defendants, which is a burdensome and risky task.[30] This room for 'strategic appeals' raised the question of whether any appeal, e.g.

[27] Follow-on claims are launched after a public investigation and sanction of the anti-competitive behaviour, as opposed to stand-alone cases concerning conduct that was not sanctioned by competition authorities. Claimants in stand-alone cases bear a much larger burden in proving the anti-competitive conduct.

[28] See further chapter 6.

[29] See e.g. Kortmann and Wesseling (2013, 5), Geradin and Grelier (2014, 14), Weidt (2014, 440-441) and Kortmann (2012, 699).

[30] See Article 11 of the Directive, and section 6.4 in chapter 6.

challenging the calculation of the fine, but not the finding of an infringement, should trigger the suspension of the limitation period. It also raised the question of whether appeals by all parties to the infringement must have run out before a decision is considered final regarding each infringer.[31]

The additional grace period has also been criticised because it is a concept generally unknown to other areas of law, which could be at odds with legal certainty (Kortmann and Swaak, 2009, 348). It has furthermore been noted that the 'open-ended' liability caused by the additional grace period runs counter to the legal certainty that limitation periods ought to provide to defendants (Kortmann, 2012, 699).[32] Since detection, public investigations and appeals may take several years, the additional grace period can extend the five-year limitation period considerably (Kortmann and Swaak, 2009, 349). Nevertheless, one may wonder whether this uncertainty argument should outweigh the benefit of ensuring compensation to claimants who may be discouraged from suing if they cannot await the final decision of the competition authority, especially when it concerns small enterprises and consumers. A decision by the competition authority serves as proof of fault in court, reducing the difficulties for claimants in follow-on cases to meet the evidentiary burden. A more convincing argument against the additional grace period than the effects on legal certainty may therefore be that an alternative is available to deal with the problem of lack of proof: rules on access to documents can provide claimants with the necessary evidence as well. The disadvantage remains that claimants face the risk that the competition authority's decision is overturned on appeal, considerably lowering their chances of succeeding in civil court. However, since in this case the defendant is cleared from involvement in a competition law infringement, it is difficult to see why any other party than the claimant should bear the claimant's litigation spending up to that point: like in any civil claim, there is some probability of losing the case.

The possibilities of gathering evidence through the public proceedings have also

[31] See section 5.3.3 below.

[32] See also Confederation of Swedish Enterprise, response to the Commission White Paper, 2008, available at `http://ec.europa.eu/competition/antitrust/actionsdamages/white_paper_comments.html`.

raised criticism as to why the Directive does not distinguish stand-alone cases and follow-on cases with respect to the limitation period. In the context of follow-on actions, the optimal or necessary limitation period is arguably much shorter than for stand-alone cases, where claimants need time to gather evidence to substantiate their claim (Renda et al., 2007, 535-537; Geradin and Grelier, 2014, 14). A shorter, fixed limitation period has been argued to be in the interest of claimants as well, since it would foster settlements. When defendants settle with one claimant, this may 'open the floodgates' to other claims. The minimum limitation period leaves uncertainty on the number of claims still to come, which may discourage defendants from settling early on (Kortmann and Wesseling, 2013, 5).[33] Nevertheless, if indeed new claimants learn about their right to compensation by a settlement offered to other claimants, this is desirable from a perspective of full compensation of harm. Although it would be problematic if claimants acted strategically, waiting to file their claim until others have obtained a settlement in order to 'free-ride' on their litigation investments, this does not appear to happen in reality. Claimants have much to gain from suing earlier rather than later, such as a lower risk that defendants are unable to pay. Even if long limitation periods discourage quick settlements, it is still questionable whether we would observe early settlements if the limitation periods were short. Defendants appear to have other interests in prolonging the proceedings. One of these interests stems from the Directive itself, namely the rules on contribution, which leave a settling defendant exposed to liability (Kortmann and Wesseling, 2013, 8-9).

Summarizing, the scholarly critique on the rules in the Directive broadly capture two concerns. The first concern is that the long duration of the limitation period will undermine legal certainty and discourage defendants from settling with claimants early on. The second concern is that the Directive leaves variation in limitation periods across EU Member States, while at the same time undermining the internal coherence of Member States' civil law systems.

[33] See also Geradin and Grelier (2014, 14), Weidt (2014, 440-441) and Kortmann (2012, 699).

5.3 Comparing Member States' rules

The extent to which the last concern will turn out to be a problem depends on the current differences in rules on limitation periods across the Member States, as well as the impact of the Directive on these rules. This impact, in turn, depends on the way in which the Member States choose to implement the Directive as well as on the clarity of the terms in the Directive. In 2004, the Ashurst report found the rules on limitation periods to differ markedly across Member States, leading to uncertainty among litigants (Waelbroeck et al., 2004, 111-112). This section provides a new comparative overview, conducted on the basis of Member States' laws, policy documents and country reports. A table listing the main rules regarding limitation periods and their source is included in the Appendix**.[34] The section also evaluates the remaining differences once the rules in the Directive will have been implemented.

5.3.1 Current Member States' rules

Member States' rules on limitation periods differ on the following points: i) the starting moment of the limitation period, ii) the duration of the limitation period and iii) whether the limitation period is suspended for the duration of public proceedings.

The majority of Member States has an objective limitation period in place, in most cases coupled with a subjective period (see Table 5.1 below). An objective limitation period starts to run at the moment the facts occurred or the harm was materialised, whereas a subjective limitation period only starts to run when the claimant has knowledge of the infringements (and, in some cases, also of the liable

[34] In addition to Member State's legislations the following reports were used to compile the comparative overview: Global Competition Review Reports, available at `http://globalcompetitionreview.com`; International Comparative Legal Guides, available at `http://www.iclg.co.uk`; Private Antitrust Litigation: Jurisdictional Comparisons, B. Adkins and S. Beighton (eds.), Sweet & Maxwell 2013; Private Antitrust Litigation 2013 Getting the deal through, available at `http://www.chsh.com`; The Private Competition Enforcement Review, I. Knable Gotts (ed.), Law Business Research Ltd 2015.

party). All but six Member States have a subjective limitation period in place, but rules vary on the definition of the 'knowledge' the claimant needs to have before the limitation period starts to run. This 'required knowledge' is the knowledge that is deemed sufficient for the claimant to file his claim, thereby justifying that the limitation period starts to run. In most cases, the subjective limitation period also starts when the claimant could, or should have, had the required knowledge. Additionally, some Member States couple the knowledge requirement with the condition that the infringement has ceased (e.g. Germany). A small majority (11 Member States) provides for suspension during public proceedings, a specific provision for antitrust damages actions, although many of these provisions have been introduced recently and will not yet apply to claims currently being filed (for example in Croatia, France, Malta and Slovakia). The rationale for these suspension provisions is to offer claimants the possibility to file their claim after the public proceedings have been finalised, to increase their chances in court.

Indeed, various Member States changed their limitation periods during the last years, meaning that for many antitrust claims filed now the old regime still applies. Some Member States included a grace period similar to the one in the Directive, which starts when the public infringement decision has become final. The rationale for these grace periods is similar to the one for suspension of the limitation period during public proceedings: to facilitate claimants in their possibilities to sue for damages. The length of this period differs considerably, ranging from six months in Austria to five years in Bulgaria. In Bulgaria and Romania, this type of limitation period is the only one in place for antitrust damages claims. In the United Kingdom, the grace period only applies to proceedings before the Competition Appeal Tribunal. A few Member States increased the length of the limitation period (Cyprus and Sweden), or decreased it (Denmark) in the last decade. Some others opted for a different combination of objective and subjective periods (Finland, Hungary and Malta). Overall, the landscape of limitation periods applicable in EU Member States changed significantly in the last decade.

Only subjective	**Only objective**	**Subjective & Objective**	**Suspension or extra period after public decision**
Malta (2 years), France and Italy (5 years), United Kingdom (6 years), Latvia and Luxembourg (10 years)	Lithuania (3 years), Hungary (5 years), Cyprus and Ireland (6 years), Finland and Sweden (10 years)	Croatia and Slovenia (3 & 5 years), Denmark, Estonia and Germany (3 & 10 years), Poland (3 & 10 years), Portugal (3 & 20 years), Austria (3 & 30 years), Czech Republic and Slovakia (4 & 10), Belgium, Greece and Netherlands (5 & 20 years)	Croatia, Germany, Malta and Slovenia (until decision), Austria (6 months), Finland, Hungary and Spain (1 year), Romania and United Kingdom (2 years), Bulgaria (5 years)

Table 5.1: Limitation periods in EU Member States

5.3.2 The impact of the Directive

In order to illustrate what these limitation periods mean for claimants, and what the impact of the Directive will be, Figure 5.1 presents a hypothetical example in which the claimant obtains the knowledge required for subjective limitation periods to commence when five years have passed since the damage occurred;[35] actual knowledge overlaps with the moment the claimant should have had this knowledge; the term 'knowledge' is interpreted in the same way everywhere;[36] and the final decision of the competition authority or Commission (including appeals) is rendered five years after the claimant obtained this knowledge.[37]

As Figure 5.1 illustrates, limitation periods may overlap (e.g. in France and the United Kingdom), and wherever the objective limitation period has run out, the subjective period is cut off (e.g. in Croatia and Slovenia).[38] Only three Member States currently have subjective limitation periods in place that exceed the five-year period (Latvia, Luxembourg and the United Kingdom), meaning that most of the subjective limitation periods will have to be amended to comply with the Directive. At the same time, many of the absolute limitation periods may have limited practical impact. The absolute limitation periods exceeding 10 years are all coupled with a subjective period that may very well cut off the objective periods. This is in any case true in this example, but may be different if claimants take a much longer time to become aware of the infringement. However, shorter objective time limits will be prohibited by the Directive for rendering it excessively difficult to file claims (Preamble, Para. 36 of the Directive, see further section 5.3.3 below).

[35] Bearing in mind that anticompetitive conduct usually lasts for several years, five years could be seen as a minimum for the period of time likely to pass between the occurrence and the detection of the harm.

[36] National courts have interpreted 'knowledge' differently (see subsection 5.3.3). This hypothetical example aims to show the variation in rules even in the absence of such different interpretations.

[37] The list of cartel cases published on the Commission website shows that five years is a modest estimation. Including the appeals, cases generally take much longer, at least at the Commission (http://ec.europa.eu/competition/cartels/cases/cases.html.

[38] The hypothetical example does not include the possibilities that the infringement has ceased or the proceedings started *after* the claimant obtains the necessary knowledge, which may alter the situation in some Member States.

Overall, the rules allowing for suspension during public proceedings are likely to leave the most post-Directive variation, unless Member States adapt their rules to the one-year grace period in the Directive.

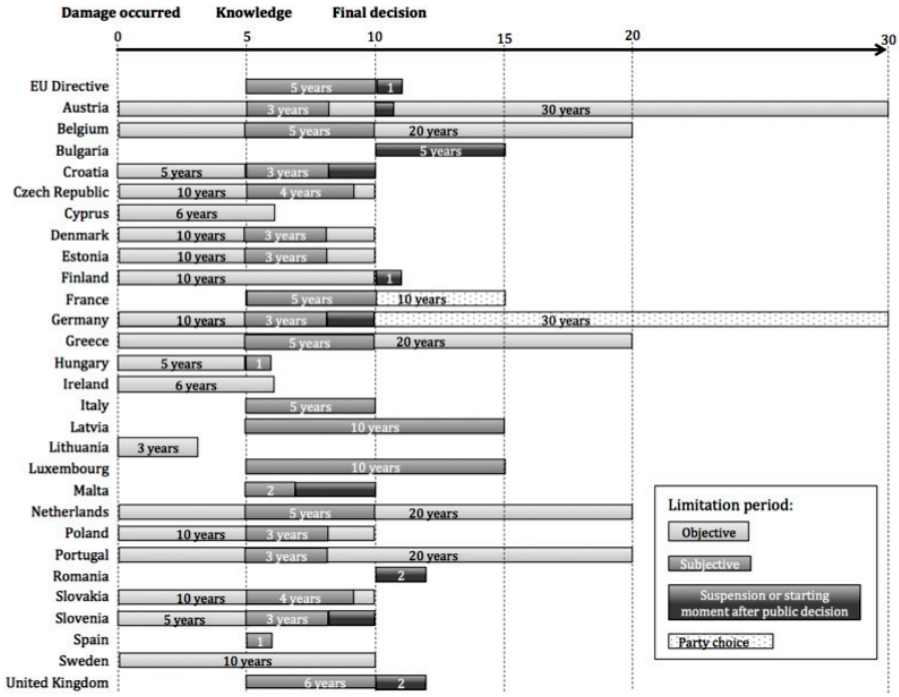


Figure 5.1: An example of the current landscape of limitation periods

In the example illustrated in Figure 5.1, a claimant will find his claim time-barred in only three out of 28 Member States at the moment he obtains knowledge of the infringement. In two of these Member States, Croatia and Slovenia, this is the case only if the competition authority or Commission did not start an investigation within five years after the occurrence of the damage. Once the decision has become final, the claimant will find his claim time-barred in 17 out of 28 Member States. Of the remaining 11 countries, in three the possibility for the claimant to still file his claim depends on whether the subjective period had not yet run out before

the public investigation started (Malta, Croatia, and Slovenia).

In short, the current limitation rules may form a real obstacle to compensation for injured parties in many Member States. Particularly the short objective periods are problematic, since these do not take into account the time it took the claimant to learn about the infringement and the damage. Regarding the subjective time limits, lengthy proceedings are the key obstacle to compensation. The additional grace period provided for in the Directive mitigates this problem of claims being time-barred while public proceedings are still ongoing. Regarding the desirability of the length of the limitation period in the Directive, it can thus be said that the Directive helps to ensure that claimants have a real opportunity to file their claim, although the instrument of an additional grace period brings along the problems discussed in section 5.2.2 above.

5.3.3 Remaining sources of variation

Some variety in rules on limitation periods is still likely to remain once the Directive is implemented, as a result of differences in implementation, unclear terms in the Directive that leave room for interpretation, and national rules that affect limitation periods but that are not regulated by the Directive. In the following, each of these remaining sources of variation is discussed.

Implementation by the Member States

The Directive only prescribes a minimum standard, allowing Member States to specify longer limitation periods. How Member States have chosen to implement the Directive is therefore relevant for the effects that it will have on the length of limitation periods for filing claims and on the uniformity of the applicable rules. Member States had to transpose the Directive into national law before the end of 2016. They had the following options in adapting their legislation to comply with the Directive:

1. Copy the rules in the Directive;

2. Specify longer limitation periods than minimum standards specified in the Directive.

   (a) The longer limitation periods apply to all civil claims in that Member State;

   (b) The longer limitation periods apply only to antitrust damages claims.

Option 1 is preferable from a perspective of uniformity of rules in the EU, while option 2a better serves the internal coherence of a Member State's legal system. Option 2b is inferior to options 1 and 2a in both of these respects. No Member States chose the drastic option 2a, adopting the limitation period from the Directive for all civil claims. This is unsurprising, since the general limitation period is based on a broad range of considerations, going beyond the aims of the Directive. Option 1 is the simplest way for Member States to implement the Directive, and ensures uniformity across the EU. This may be different for Member States that already had a limitation period in place that went beyond the minimum standard in the Directive. For reasons of legal certainty these Member States have an interest in choosing to maintain their longer limitation period, rather than changing it again.[39]

An example of a Member State that chose to go beyond the minimum rules in the Directive is the United Kingdom. The United Kingdom adopted the Consumer Rights Act in October 2015, extending the limitation period at the Competition Appeal Tribunal[40] to six years and bringing it in line with the procedure at the High Court.[41] The United Kingdom thereby partly followed option 2a, ensuring

[39] An overview of the implementation laws of the Directive by the Member States can be found on the Commission's website: `http://ec.europa.eu/competition/antitrust/actionsdamages/directive_en.html`.

[40] The Competition Appeal Tribunal (CAT) hears appeals against competition law decisions taken by the UK's competition authority.

[41] Consumer Rights Act 2015, available at `http://www.legislation.gov.uk/ukpga/2015/15/contents/enacted`. This has also been included in 'The Claims in respect of Loss or Damage arising from Competition Infringements (Competition Act 1998 and Other Enactments (Amendment)) Regulations 2017, available at `http://www.legislation.gov.uk/ukdsi/2017/9780111152805`.

internal coherence regarding antitrust damages claims but differing from the limitation period in the Directive, and therefore diverging from most other Member States.

Luxembourg followed the approach of the Directive to further the principles of equivalence and effectiveness, thus adopting option 1.[42] The Dutch proposal follows option 1 as well, with the implementation act following the provisions of the Directive in terms of the subjective limitation period and the additional grace period, and maintaining an objective limitation period of twenty years.[43] Similarly, the Finnish proposal adopts option 1 by copying the rules of the Directive, but maintaining the ten-year objective limitation period that was introduced in 2011.[44] Germany, too, maintains the ten-year long stop while prolonging the subjective limitation period to five years in order to comply with the Directive.[45] It is questionable to what extent objective limitation periods, such as the one in Germany, are compatible with the Directive (See section 5.3.3 below).

Unclear Terms

A second remaining source of uncertainty concerns some unclear terminology in the Directive. Such unclear terminology may lead to diverging interpretations by

[42] 'Loi du 5 décembre 2016 relative à certaines règles réglissant les actions en dommages et intérêts pour les violations du droit de la concurrence et modifiant la loi modifiée du 23 octobre 2011 relative à la concurrence', available at `http://legilux.public.lu/eli/etat/leg/loi/2016/12/05/n1/jo`. See also 'Projet de loi relatif à certaines règles régissant les actions en dommages et intérêts pour les violations du droit de la concurrence et modifiant la loi modifiée du 23 octobre 2011 relative à la concurrence, available at `http://chd.lu/wps/PA_RoleEtendu/FTSByteServingServletImpl/?path=/export/exped/sexpdata/Mag/153/536/155325.pdf`.

[43] Implementatiewet richtlijn privaatrechtelijke handhaving mededingingsrecht, Artikel 193s, 193t, available at `https://www.internetconsultatie.nl/implementatiewet_richtlijn_privaatrechtelijke_handhaving_mededingingsrecht`.

[44] Finnish Government proposal for a new Act on Antitrust Damages Actions, available at `https://www.eduskunta.fi/FI/vaski/HallituksenEsitys/Documents/HE_83+2016.pdf`.

[45] Entwurf eines Neunten Gesetzes zur ánderung des Gesetzes gegen Wettbewerbsbeschránkungen (9. GWB-ÄndG), 1 July 2016, available at `https://www.bmwi.de/BMWi/Redaktion/PDF/G/neunte-gwb-novelle,property=pdf,bereich=bmwi2012,sprache=de,rwb=true.pdf`.

national courts, which would undermine the goal of providing a uniform Union approach.

The most prominent example of an unclear term is the 'knowledge' required for the limitation period to commence. The ambiguity of this term is illustrated by the varying interpretations that national courts have given it in the past, even within Member States. In the Netherlands, the Dutch Rotterdam District Court ruled that a claimant was aware of the damage and the liable party when he sent a letter to the Commission complaining about anti-competitive conduct that later resulted in an infringement decision. As a result, when the claimant sued after the infringement decision was rendered, his claim was found to be time-barred.[46] In a more recent ruling, the East-Netherlands District Court rejected the argument that a press release regarding an investigation was sufficient to start the limitation period.[47] The Court of Appeal upheld this decision, clarifying that the claimant should have sufficient certainty regarding the liability of the party. The press release did not imply a conviction, and the limitation period only started to run when the Commission rendered its decision.[48] In Finland, the District Court in the *Asphalt* case found that only the final, non-appealable ruling of the Supreme Administrative Court provided the plaintiffs with sufficient knowledge to raise actions, regardless of the wide media coverage of the case.[49] The District Court in another Finnish case (*Timber*) took a markedly different approach, ruling that the limitation period started to run when the competition authority announced the investigation. The Helsinki Court of Appeal overturned this ruling, following the ruling in the *Asphalt* case. The court noted that the press release on the investigation did not provide any certain information that an infringement had actually occurred. The proposal the competition authority made for the fine to be imposed on the defendants was still too unclear to establish sufficient awareness to file a claim.[50] A high threshold for the required knowledge

[46] Rotterdam District Court 7 March 2007, LJN BA0926.
[47] Oost-Nederland District Court, 16 January 2013, LJN BZ0403, Paras. 4.22-4.24.
[48] Court of Appeal Arnhem-Leeuwarden 2 September 2014, ECLI:NL:GHARL:2014:6766, Paras. 3.20-21.
[49] District Court of Helsinki, judgement 13/64929, on November 28, 2013.
[50] *The Finnish Competition Authority v. UPM-Kymmene Oyj, Stora Enso Oyj and Metsäliitto*

also applies in Germany, where the limitation period only starts if the claimant would have obtained knowledge of the harm and the liable party if he had not shown gross negligence.[51] In Italy the relevant moment is usually the day of publication of the competition authority decision.[52] However, in 2011 the Milan Court held that where the claimant is a company, the limitation period should start as early as the day of the publication of the commitments or the day of the statement of objections.[53]

All these interpretations fit with the knowledge requirement enshrined in the Directive, which is not further specified in the Directive itself. Without further guidance, national courts are likely to reach different conclusions regarding the starting moment of the limitation period. This can have detrimental consequences, causing uncertainty for litigants across the EU and potentially time-barring claims. Other than the uncertainty that is left by the implementation of the Directive into national law by the Member States, which is the result of a deliberate choice for minimum harmonisation, this source of variation could have been easily prevented. Rather than using the subjective phrase 'when the claimant knows, or can reasonably be expected to know' the Directive could have specified a specific moment during the investigation as the starting point for follow-on cases.

While this moment might in some cases not coincide with the moment when the claimant actually obtained knowledge of the infringement, which might be deemed unfair, such an objective starting moment would considerably reduce uncertainty and the scope for diverging interpretations by courts. Only for stand-alone cases would courts have to determine the starting moment. In follow-on cases, the vast majority of cases, the litigation costs now spent repeatedly on this issue would be saved. Moreover, other than the objective periods starting at the occurrence of the damage, such a rule would still account for the long period of time that it might take for anti-competitive conduct to be detected or revealed.

Osuuskunta, Case MAO:614/2009, Market Court, 3 December 2009.

51 Section 199(1) of the German Civil Code.

52 Court of Cassation, judgement No 26188 of 6 December 2011.

53 Tribunal of Milan, 20 May 2011.

A second source of uncertainty is the term 'final decision'. The one-year grace period starts to run when the infringement decision has become final. However, the Directive fails to specify whether this is determined for each defendant individually, or regarding the decision as a whole. Nor does it specify whether an appeal regarding only the amount of the fine, and not the infringement, postpones the moment at which the decision becomes final. The effect of appeals on the limitation periods for follow-on claims is of great interest for both claimants and defendants. The issues were litigated in the United Kingdom, where the relevant courts held that an appeal against the fine only did not prevent the decision from becoming final,[54] and appeals by one defendant did not suspend limitation periods with respect to non-appealing defendants in the same case.[55] The Directive risks replicating the problems that were experienced in the United Kingdom, rather than providing a clear rule (Wisking et al., 2014, 188; Peyer, 2014). It will now be up to national courts and the Court of Justice to ensure uniformity using the preliminary reference procedure of Article 267 TFEU.

Finally, uncertainty remains regarding the possibility of Member States to maintain or introduce absolute limitation periods. The Directive allows Member States to maintain or introduce longer absolute limitation periods, as long as they do not render the exercise of the right to full compensation 'practically impossible or excessively difficult'.[56] However, it remains unclear what this means exactly for the absolute limitation periods that Member States have in place. The hypothetical example presented in Figure 5.1 illustrated that if claimants take five years to detect the infringement, and public proceedings take another five years, limitation periods will have run out in various Member States with objective limitation periods. On this basis and in light of the goal of the Directive, it appears that absolute periods of ten years or less should not be permitted. This would mean that

[54] *Emerson Electric Co and others v Morgan Crucible* (Emerson I) [2007] CAT 30; *Emerson Electric Co and others v Morgan Crucible* (Emerson II) [2007] CAT 28; *Emerson Electric Co and others v Morgan Crucible* (Emerson III) [2007] CAT 8; *BCL Old Co Ltd v BASF* (BCL I) [2008] CAT 24; and *BCL Old Co Ltd v BASF* (BCL II) [2009] CAT 29.

[55] *Deutsche Bahn AG and others v Morgan Crucible Company plc* [2014] UKSC 24. See Akman (2014, 14-16) for a comment on these rulings.

[56] Directive, Preamble para. 36.

the recent Finnish policy change introducing such an objective limitation period would be incompatible with the Directive.[57] The legality of periods of fifteen or twenty years, however, is more difficult to determine.

Rules That Are Not Affected by the Directive

A final source for remaining variation concerns aspects of limitation periods that the Directive does not regulate. Most notably, this concerns the actions needed to suspend the limitation period (Geradin and Grelier, 2014, 14). In the Netherlands, for example, the limitation period can be suspended by simple written notification.[58] This means that claimants can easily stop the limitation period from running, even before they have gathered any evidence to substantiate their claim. Some Member States maintain stricter conditions, such as a judicial act, to interrupt the limitation period.[59] As a result of variation in these additional rules, the time that claimants effectively have to file their claim will continue to differ across Member States.

5.4 Conclusion

It appears that the Directive will considerably reduce the variation in limitation periods of the Member States, both regarding their duration and with respect to the starting moment. The Directive addresses the problem of claims being time-barred before claimants became aware of the harm by stipulating a limitation period that only commences once the public decision has become final. This should contribute to a more effective private enforcement of competition law in the EU. It remains to be seen, however, what the impact of this one-year grace period will be on litigation dynamics, in particular incentives to settle early on,

[57] However, other commentators appear to find such a duration compatible with the Directive, e.g. Bien et al. (2015, 15).

[58] Section 3:317(1) of the Dutch Civil Code.

[59] E.g. France, Germany and Belgium. See Bird& Bird, 'Statute of limitation - EMEA comparative table', available at `http://www.twobirds.com`.

since appeals by defendants will prolong the limitation period. Moreover, the Directive does not create a complete level playing field with regard to limitation periods, for three main reasons.

First, variation in limitation periods may remain if Member States implement the Directive in different ways. The policy advice to Member States is to adopt the minimum standards in order to ensure uniformity throughout the EU. Nevertheless, some Member States whose rules already go beyond these minimum standards may, for legitimate reasons, choose to maintain them. A second source of uncertainty stems from unclear terms in the Directive that leave room for interpretation. It remains to be seen whether the preliminary reference procedure at the Court of Justice will be effective in avoiding diverging interpretations. Thirdly, the Directive does not provide rules on some aspects of limitation periods, most notably the requirements to interrupt the limitation period.

Insofar as the remaining differences in rules result from unclear terms in the Directive this is regrettable, since the resulting variation was unintended and may not reflect the broader aim of the Directive. Moreover, including clearer definitions would have ensured more uniformity at negligible extra costs. In order to get the best out of the Directive, it is to be hoped that national courts, together with the Court of Justice, will strive to minimise divergences in the interpretation of the Directive.

The variation resulting from the minimum standards and the limited scope of the Directive, however, are a direct result of the policy choices made by the European Commission. Although these remaining differences in national rules may lead to uncertainty for litigants or to forum shopping, they also reflect varying legal systems and preferences for rules across Member States. Moreover, the policy discretion left to Member States still allows for some opportunities for learning and experimentation.

Nevertheless, this chapter has aimed to illustrate an additional consideration in determining how much harmonisation is desirable: the impact of the scope of the harmonising legislative instrument. On the basis of a newly compiled comparative

overview, the chapter has illustrated that Member States' rules on limitation periods vary considerably, not only in length but also in various additional rules such as the starting moment and possibilities for suspension. The Directive partly covers these additional rules, but continues to leave some aspects up to the Member States. This means, on the Member State level, that i) claimants will continue to face different rules depending on the Member State where they file their claim, and ii) claimants will face different rules within a Member State depending on whether their claim relates to antitrust infringements or to other violations of the law. The implication of the first, that claimants' positions differ across Member States, is that the goal of enhancing a level playing field in the internal market may not be fully achieved. The second, that procedural rules start to diverge depending on the basis for claims, implies that Member States' legal systems may start to lose their internal coherence and consistency as piecemeal harmonisation progresses. The more general lesson for harmonisation in the field of civil and procedural law is that the value of internally coherent national legal systems should be taken into account when considering the introduction of further European initiatives containing procedural rules for specific areas.

Chapter 6

Leniency and Damages: How to Treat the Whistleblower?

The previous chapter evaluated whether the Antitrust Damages Directive succeeds at creating a 'level playing field' for damages actions in the EU with regard to limitation periods, and whether specific limitation period rules for antitrust damages actions are desirable. The chapter highlighted that it is relevant to consider the effects of the scope of an EU legislative instrument when determining if harmonisation in the proposed form is desirable. Legislative instruments with a limited scope, such as the Antitrust Damages Directive, are likely to leave differences in rules within Member States, depending on which legal area a claim relates to, and across Member States. As a result, the aim of achieving a level playing field in the EU may not be (fully) achieved. This does not necessarily mean that broader or further harmonisation is desirable. Instead, it implies that when considering the benefits of harmonisation in this area, the benefits for the internal market should not be overstated.

As was mentioned in chapter 5, the goal of improving the internal market and creating a level playing field for damages actions is not the only objective of the Antitrust Damages Directive. The Directive is also based on Article 103 TFEU,

on competition law matters, and pursues full compensation of antitrust harm.[1] This chapter focuses on this second goal of harmonisation in the Directive. The chapter evaluates whether the Directive is likely to achieve full compensation of antitrust harm, in light of a particular aspect of private enforcement in the area of competition law: its interplay with public enforcement. Public enforcement of cartels largely relies on the leniency program, which offers exemption from public fines in exchange for revealing the cartel. Private damages actions may affect the attractiveness of the leniency program, and consequently a tension exists between public and private antitrust enforcement.

This chapter examines to what extent the Directive succeeds at resolving this tension by stipulating special liability rules for firms that reported a cartel. It considers the impact of these substantial rules in the Directive in light of the compensatory objective of harmonisation that underlies this Directive, and compares them with the rules applicable in the United States.

The remainder of the chapter is organised as follows. Section 6.1 explains the tension between public and private antitrust enforcement. Section 6.2 offers a literature review of economic models of leniency programs and public and private antitrust enforcement. This is followed by a game-theoretic analysis of the impact of private enforcement on the leniency program in Section 6.3. Section 6.4 discusses the relevant liability rules in the EU and the U.S. and evaluates these rules using the findings of the game-theoretic analysis. Section 6.5 concludes.

6.1 Public and private antitrust enforcement

In the European Union, antitrust enforcement has so far primarily relied on public enforcement by competition authorities. In the years leading up to the adoption

[1] Preamble para. 54 of the Directive; Proposal for a Directive of the European Parliament And of the Council on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union, COM(2013) 404 final, pp. 2-5.

of the Antitrust Damages Directive, the number of private damages actions already increased considerably, especially in the United Kingdom, Germany and the Netherlands. Nevertheless, private damages actions still play a limited role in the EU as compared to the United States.[2]

Whereas private actions for damages generally stand on their own, in the context of antitrust violations, in particularly cartels, they are often initiated subsequent to a public decision by a competition authority sanctioning the behaviour (Kuijpers et al., 2015). A reason is that, without such a public sanction, affected parties are to likely not even be aware that the firms they bought from were involved in a cartel. One rationale for the Antitrust Damages Directive is to facilitate damages claims for injured parties in these secretive circumstances.

The reason why private enforcement affects public enforcement is that public enforcement of cartels largely relies on cartel members revealing the cartel to the authorities under the leniency program, in exchange for reductions or exemption from the public fine. The prospect of damages liability in civil claims may discourage cartel participants from applying for leniency, since the leniency program exempts them only from the public fine, and not from liability for damages. If the leniency program would no longer be attractive for cartel members, this would likely result in most cartels remaining undetected, since the vast majority of known cartels was revealed through the leniency program (Miller, 2009; Brenner, 2009). This, in turn, would leave most harm uncompensated, since most civil damages claims are follow-on claims that rely on a decision of a competition authority. The potential impact of damages claims is illustrated by recent cases, most notably the air cargo cartel. Lufthansa was exempted from its share of the EUR 800 million fine for reporting the air cargo cartel to the European Commission,[3] but was subsequently sued with the other cartel participants for EUR 3 billion by

[2] For an overview of recent cases in the United Kingdom, Germany and the Netherlands see e.g. Kuijpers et al. (2015, 1). As they note, most cases are still in a preliminary phase as they have only been launched recently. As a comparison, until 2004 only 60 damages actions were reported in the EU, compared to almost 700 cases in the U.S. in only two years. See also Scharaw (2014, 356) and Ginsburg (2005, 435).

[3] `http://ec.europa.eu/competition/cartels/cases/cases.html`.

Deutsche Bahn - the first of many potential claimants.[4]

In order to address the tension between public and private antitrust enforcement, the drafters of the Directive have included several rules designed to favour the firm receiving immunity from fines (the *immunity recipient*) as compared to the non-cooperating firms. These rules include a special liability regime for immunity recipients.[5] In the U.S., such special rules on punitive damages and joint and several liability have been in place for some time, although the rules differ considerably from the new European rules.

This chapter studies the impact of the EU and U.S. liability rules in private damages actions on incentives of cartel members to apply for leniency. Previous literature has addressed the interaction between leniency programs and private damages actions using formal (game-theoretic) approaches, finding that it is necessary to exempt the immunity recipient or reward him in order to maintain incentives to apply for leniency (Spagnolo, 2004; Silbye, 2012; Buccirossi et al., 2015). This chapter aims to contribute to this literature by also evaluating the impact of the special liability rules applicable in the EU and the U.S., that do not fully exempt the immunity recipient or reward him. The chapter finds that shifting part of the liability from immunity recipients to the non-cooperating firms may be sufficient to maintain incentives to apply for leniency. The U.S. rules indeed appear to achieve this, while the EU rules do not create a difference between the liability of the immunity recipient and that of non-cooperating firms. The chapter thus concludes that the U.S. rules are superior to the EU rules in terms of reconciling compensation of injured parties and leniency incentives. An implication is that the Antitrust Damages Directive, while pursuing the compensation of antitrust harm, may not in all respects include the appropriate substantial rules to achieve this aim.

[4] See e.g. `http://www.reuters.com`, 'Deutsche Bahn airlines'.

[5] Directive on Antitrust Damages Actions, Article 11 and Preamble para. 38.

6.2 Literature

A growing economic literature studies the interaction between leniency and damages. This literature builds on the extensive literature on the design of leniency programs as a means to enhance the deterrent effect of competition law. These papers study leniency programs as a Prisoners' Dilemma using a game-theoretic framework, finding broadly that leniency programs may help to prevent the formation of cartels, but may also have the unintended effect of stabilising existing cartels. Motta and Polo (2003) conclude that an optimal leniency program offers full immunity to all firms that cooperate with the competition authority. However, they also find that a leniency program may help to stabilise cartels, as it prevents defection from the cartel agreement. Buccirossi and Spagnolo (2006) and Brisset and Thomas (2004) find that a leniency program that rewards the first firm that reports the cartel to the competition authority may prevent cartel formation, thereby enhancing ex ante deterrence. At the same time, rewarding whistleblowers also decreases the expected fine for colluding, thereby potentially undermining deterrence (Buccirossi and Spagnolo, 2007). Entering into a cartel with the sole aim to reveal it and obtain the reward may become a profitable strategy for firms (Aubert et al., 2006). Spagnolo (2004) finds that the best leniency programs reward the first firm to come forward and do not offer any reductions to the other cartel members. Further complexities of the strategic choices of colluding firms in relation to leniency programs are discussed by e.g. Ellis and Wilson (2003), Chen and Harrington (2007), Harrington (2008) and Hoang et al. (2014).

Civil damages further complicate matters, as they - as a general rule - affect all firms that were involved in the cartel regardless of their cooperation in a leniency program. Game-theoretic analyses of the interplay between leniency and damages have shown that leniency programs that only exempt self-reporting firms from fines, and not from damages, are inefficient from a deterrence perspective (Spagnolo, 2004). Colluding firms will have low incentives to report the cartel if they still face substantial damages claims. Green and McCall (2009) therefore propose to extend leniency to civil liabilities as well. Silbye (2012) finds that

even if competition authorities can adjust leniency programs in response to a higher damage level, private actions may enhance the scope for collusion rather than deter collusion. This is the case if competition authorities are not allowed to reward self-reporting firms, which is the applicable rule in most jurisdictions, including the U.S. and the EU.

A number of scholarly contributions have criticised the Directive for not adequately addressing the tension between antitrust damages actions and public antitrust enforcement.[6] Some recent contributions have proposed alternative solutions for liability that would not undermine incentives to report the cartel. Cauffman (2011) proposes the adoption of the Hungarian approach, in which the immunity recipient can only be approached by claimants if their claims cannot be collected from other undertakings being held liable for the same infringement.[7] Buccirossi et al. (2015) formalise this proposal, finding that the rules in the Directive regarding liability and access to documents are outperformed by the alternative chosen in Hungary.[8] Kirst and Van den Bergh (2016) offer another alternative, namely a rule granting immunity or a reduction in damages in proportion to the reduction that the particular firm obtained to the fine under the leniency program.

A different but related stream of literature studies the effect on deterrence of different contribution rules, the rule determining whether defendants may collect a contribution from another defendant after they have paid out more than their share of damages to a claimant in antitrust proceedings.[9] Some early theoretic literature on contribution in antitrust litigation emphasises the role of risk-aversion in the impact of contribution proceedings. Easterbrook et al. (1980) find that a rule of no contribution provides greater deterrence of anti-competitive behaviour than any rule of contribution. From a broader welfare perspective, however, they see disadvantages of a no contribution rule, mainly because of risk aversion and

6 See e.g. Cauffman and Philipsen (2015), and on the Directive more generally e.g. Vandenborre and Goetz (2013).

7 Article 88D Hungarian Competition Act. See also Nagy (2011) and Cauffman (2011).

8 See on the rules regarding access to documents also Migani (2014).

9 See Section 6.4 below.

legal error. Polinsky and Shavell (1981) reach more nuanced results regarding the deterrent effect of a rule of no contribution. They conclude that the potential for high liability under the no contribution rule may discourage firms from engaging in socially beneficial activities, while failing to deter firms behaving anti-competitively. While this literature is mixed regarding the effects of allowing contribution, a more recent paper by Hviid and Medvedev (2010) provides more clarity as to its desirability in antitrust proceedings. While the authors find several advantages of the no-contribution rule, such as that the encouragement of settlement and information revelation, they conclude that it may have detrimental effects on incentives to apply for leniency. The authors study a setting in which cartel members obtain low settlements in exchange for evidence against the other cartel participants. The leniency applicant, who already shared all information with the competition authority, is worst off since he has no additional information to offer. As such, the no-contribution rule is found to undermine the leniency program, especially in combination with a joint and several liability rule.[10] Nevertheless, if limited rules of disclosure are in place, the leniency applicant may not be negatively affected by a no-contribution rule.

6.3 Game-theoretic analysis

6.3.1 Set-up

Let there be two symmetric, risk neutral firms who have formed a cartel and are each contemplating whether to report it to the Competition Authority ('CA'). A leniency program is in place which offers the firm that reports the cartel a discounted fine (F_R) on the actual fine (F); i.e. $F_R < F$. It is possible that the reduced fine equals a full exemption from the fine, but the CA is not allowed to offer reporting firms a positive financial payment; i.e. the reduced fine is restricted such that $F_R \geq 0$.

[10] This rule stipulates that a defendant is liable for the entire harm of the cartel, see Section 6.4 below.

A non-reporting firm, if detected by the CA or revealed by its reporting competitor, will be charged the full fine $F > F_R$. If both firms self-report, each firm qualifies for the reduced fine with probability $\frac{1}{2}$.[11] The non-reporting firm pays the full fine F.[12] If neither firm reports the cartel, the cartel is detected by the CA with probability $p \in (0, 1)$. If the cartel is detected, the CA charges both firms with the full fine F. Once the cartel is revealed - be it through self-reporting or detection by the CA - the cartel is punished with certainty.[13]

As a starting point, the leniency program does not protect a self-reporting firm against private damages claims by parties that suffered harm as a result of the cartel. The law may or may not facilitate such claims: if not, firms only face public fines, but otherwise firms also face liability for civil damages, D.[14]

This model considers the simultaneous reporting strategies of firms, given the parameters chosen by the CA. The underlying timing is as follows: First, the CA decides upon the fine levels and detection probability. Next, the firms decide upon engaging in a cartel or not. Finally, each firm decides non-cooperatively upon self-reporting, based on the expected public sanction and private damages. The model treats as exogenous the values of p, F and F_R arising from the policy decisions of the CA, and focuses solely on the firms' reporting decisions.

[11] Only the firm that qualifies for the reduced fine is exempted from the fine, becoming the *immunity recipient*. In the remainder of the chapter, the firm that is not the immunity recipient will also be called the non-reporting firm, since it is treated as such even if it reported (but did so too late).

[12] The EU policy also allows for fine reductions to second and later reporting firms, provided that they can offer the CA new evidence of added value. In this model, by assumption the first firm offers sufficient evidence to prove the cartel. Therefore, similarly to earlier contributions such as Silbye (2012), the second firm can no longer offer evidence of added value and therefore does not qualify for a reduction in the fine.

[13] In the case of self-reporting, this assumption finds support in the fact that a leniency applicant must hand over all the evidence of the cartel. In the case of detection, the CA can rely on its extensive possibilities to gather evidence from colluding firms, for example through dawn raids.

[14] The amount of damages equals the harm suffered by injured parties and may consist of overcharge as well as lost sales. The relation between damages and cartel profits is not considered in the game-theoretic analysis, as it focuses on comparing different rules on damages liability. The size of cartel profits is briefly addressed in the numerical example presented in Section 6.3.

		Firm 2	
		Report (R)	**Not report (NR)**
Firm 1	**Report (R)**	$\frac{F+F_R}{2}$; $\frac{F+F_R}{2}$	F_R; F
	Not report (NR)	F; F_R	pF; pF

Table 6.1: Payoffs in a public enforcement system

6.3.2 Baseline: only fines (*public enforcement system*)

In a public enforcement system, damages actions are not facilitated and colluding firms only risk a fine by the CA. The leniency program introduces a Prisoners' Dilemma game. Payoffs are given in Table 6.1, with the payoffs of Firm 1 reported first in each cell.

Solving for the pure strategy Nash equilibria, it can be seen that the pairs (NR, R) and (R, NR) are not Nash equilibria, since the non-reporting firm can improve its outcome by also reporting (because $F_R < F$). The pair (R, R) is a Nash equilibrium regardless of the values of the parameters. The pair (NR, NR) is a Nash equilibrium if the following condition holds:

$$p < \frac{F_R}{F} < 1 \tag{6.1}$$

The CA can induce reporting by increasing the detection probability and/or the full fine, or by lowering the reduced fine. When the equilibria (R, R) and (NR, NR) can both be sustained, it is assumed that the cartel coordinates on the pay-off dominant equilibrium - i.e. the equilibrium giving the highest expected value (or, conversely, the lowest expected cost).[15] The pair (NR, NR) is pay-off dominant if

[15] *Cf.* Silbye (2012).

$$p < \frac{1}{2} + \frac{F_R}{2F} \tag{6.2}$$

Comparing equations 6.1 and 6.2, it can be seen that the first condition is the stricter one. Hence, whenever the pair (NR, NR) is a Nash equilibrium, it is also pay-off dominant.

The next question is how introducing damages liability affects the incentives to report the cartel.

6.3.3 Introducing damages liability (*normal liability system*)

It is now assumed that private damages actions are facilitated, so that cartel participants face liability to pay damages.[16] In a normal liability system, the leniency program only exempts a reporting firm from the public fine, but not from liability to pay damages. Payoffs in a normal liability system are depicted in Table 6.2, with the payoffs of Firm 1 reported first in each cell.

		Firm 2	
		Report (R)	**Not report (NR)**
Firm 1	**Report (R)**	$\frac{F+F_R}{2} + D$ $\frac{F+F_R}{2} + D$	$F_R + D$; $F + D$
	Not report (NR)	$F + D$; $F_R + D$	$p(F + D)$; $p(F + D)$

Table 6.2: Payoffs in a normal liability system

Again, the pure strategy Nash equilibria are considered. As before, the pairs (NR, R) and (R, NR) are not Nash equilibria, and the pair (R, R) is a Nash equilibrium regardless of the values of the parameters. The condition for the pair (NR, NR) to be a pay-off dominant Nash equilibrium is now as follows:

[16] All damages claims are assumed to be follow-on claims. Hence, without detection or reporting no claims are filed.

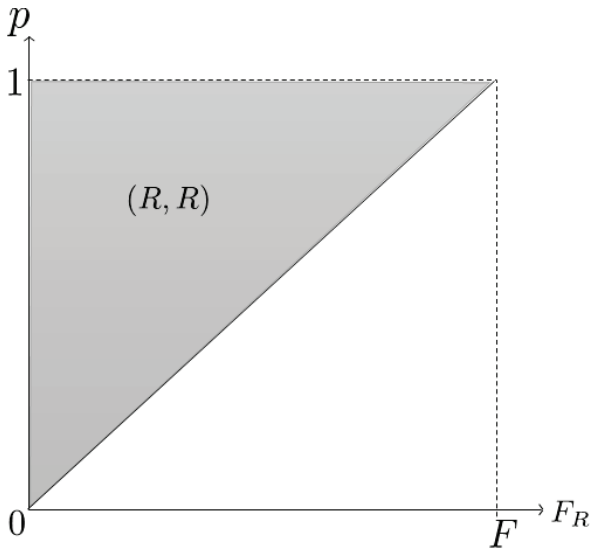
$$p < \frac{F_R + D}{F + D} \tag{6.3}$$

Given that $F_R < F$, it must be that $\frac{F_R}{F} < \frac{F_R+D}{F+D}$. This means that the condition for (NR, NR) to be a pay-off dominant Nash equilibrium is less strict in a normal liability system than in a public enforcement system. In other words, introducing a normal liability system reduces the scope for (R, R) to be a Nash equilibrium.

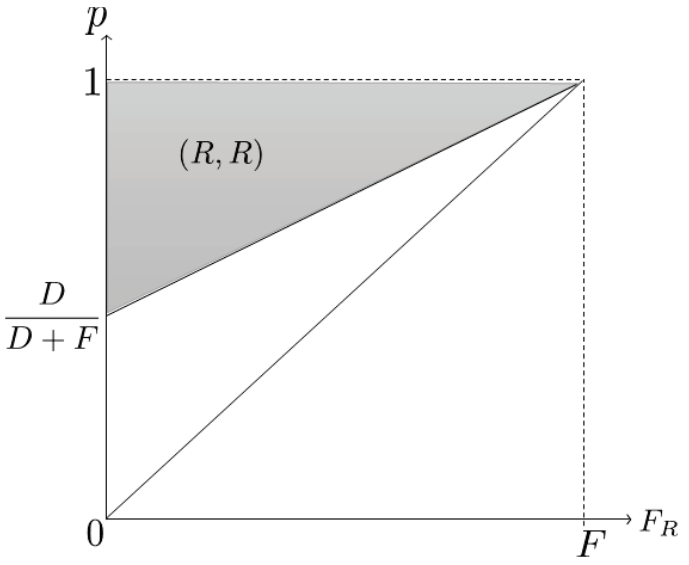
Proposition 6.1. *Introducing a normal liability system reduces reporting by colluding firms as compared to a public enforcement system.*

This effect is illustrated in Figures 6.1a-b. The line $(0, 0) - (F - 1)$ depicts the condition $p = \frac{F}{F_R}$ for which firms are indifferent between reporting and not reporting in a public enforcement system. Figure 6.1b also shows this indifference condition for a normal liability system, $p = \frac{F_R+D}{F+D}$, represented by the line $(0, \frac{D}{D+F}) - (F, 1)$. The shaded area represents the combinations of values of p, F and F_R for which firms will report the cartel, i.e. the scope for (R, R) to be a Nash equilibrium. As can be seen from Figures 6.1a-b, a normal liability system shifts the condition for firms to report upwards. A range of values of p, F and F_R exists for which firms would report in a public enforcement system, but not in a normal liability system.

In short, private enforcement introduces costs of reporting and reduces the relative benefit of reporting as compared to not reporting, leading to lower incentives to report a cartel.



(a) Public enforcement system



(b) Normal liability system

Figure 6.1: The equilibrium (R, R) under a public enforcement system and a normal liability system, for different values of p and F_R.

6.3.4 Exempting the immunity recipient from liability (*exemption system*)

A possible way to preserve incentives to report in a system with damages liability is to not only offer the reporting firm a reduced fine, but also exempt it from damages liability. In an exemption system, colluding firms face the pay-offs from reporting and not reporting the cartel as depicted in Table 6.3. Again, the payoffs of Firm 1 are reported first in each cell. It is assumed that under an exemption system, the damages liability from which the immunity recipient is exempted is borne by the other firm, in order to ensure that injured parties can still recover their harm. As a result, the cells (R, NR) and (NR, R) depict double the amount of damages, $2D$, for the non-reporting firm and no damages for the reporting firm.

		Firm 2	
		Report (R)	**Not report (NR)**
Firm 1	**Report (R)**	$\frac{F+F_R}{2} + D$; $\frac{F+F_R}{2} + D$	F_R; $F + 2D$
	Not report (NR)	$F + 2D$; F_R	$p(F + D)$; $p(F + D)$

Table 6.3: Payoffs in an exemption system

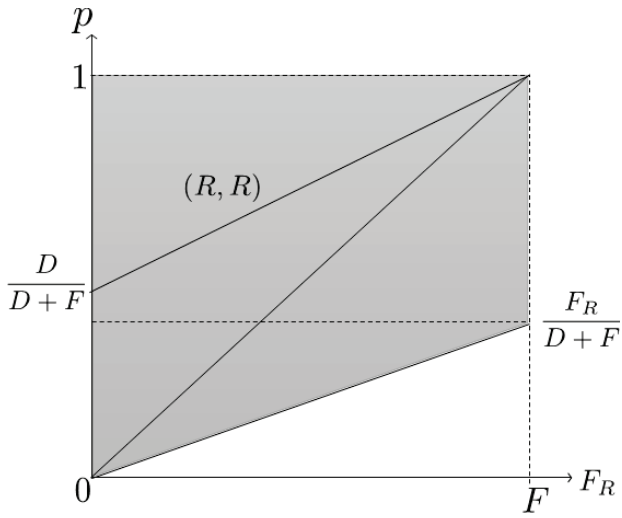
Once again, the pure strategy Nash equilibria are considered. The pay-offs for (R, R) look the same as before, although their composition is different due to the shift in liability. If the reporting firm is the immunity recipient it pays F_R, and if it is not it pays $F + 2D$. As before, the pairs (NR, R) and (R, NR) are not Nash equilibria, and the pair (R, R) is a Nash equilibrium regardless of the values of the parameters. The pair (NR, NR) is a pay-off dominant Nash equilibrium if the following condition holds:

$$p < \frac{F_R}{F + D} \tag{6.4}$$

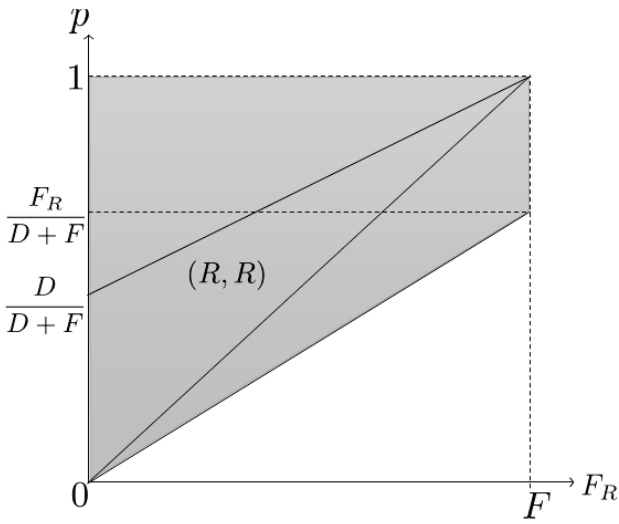
This condition is stricter than the conditions for (NR, NR) to be a pay-off dominant Nash equilibrium in a public enforcement system and in a normal liability system, meaning that exempting the immunity recipient leads to more reporting.

Proposition 6.2. *An exemption system increases reporting by colluding firms as compared to a public enforcement system and a normal liability system.*

Figures 6.2a-b illustrate this positive effect on reporting of an exemption system, for $F_R < D$ and $F_R > D$ respectively. The line $(0,0) - (F, \frac{F_R}{D+F})$ depicts the condition $p = \frac{F_R}{F+D}$ for which firms are indifferent between reporting and not reporting in an exemption system. The shaded area, representing the scope for (R, R) to be a Nash equilibrium, is larger than in a public enforcement system (represented by the line $(0,0) - (1,1)$) and a normal liability system (represented by the line $\frac{D}{D+F} - 1$). The size of the effect depends on the relative sizes of the reduced fine F_R and the damages D. The larger the damages are and/or the smaller the reduced fine is, the higher the beneficial impact is of the exemption system on reporting.



(a) Exemption system with $F_R < D$



(b) Exemption system with $F_R > D$

Figure 6.2: The equilibrium (R, R) in an exemption system for different values of p and F_R.

6.3.5 Stipulating special liability rules (*special liability system*)

The EU and U.S. legislators have chosen not to exempt the immunity recipient from liability, but to specify special liability rules for immunity recipients that differ from the liability rules applicable to non-reporting firms. Special liability rules can work in various ways:

- By reducing the damages liability of the immunity recipient (reducing the total amount of damages received by claimants)
- By shifting damages liability from the immunity recipient to non-reporting firms (not affecting the total amount of damages received by claimants)
- By increasing the liability of non-reporting firms (increasing the total amount of damages received by claimants)

With special liability rules in place, the immunity recipient is liable to pay damages equal to $D_R < D$, whereas a non-reporting firm faces a liability of $D_{NR} > D$.[17] Payoffs in a normal liability system are depicted in Table 6.4, with the payoffs of Firm 1 reported first in each cell.

		Firm 2	
		Report (R)	**Not report (NR)**
Firm 1	**Report (R)**	$\frac{F+D_{NR}}{2} + \frac{F_R+D_R}{2}$; $\frac{F+D_{NR}}{2} + \frac{F_R+D_R}{2}$	$F_R + D_R$; $F + D_{NR}$
	Not report (NR)	$F + D_{NR}$; $F_R + D_R$	$p(F + D_{NR})$; $p(F + D_{NR})$

Table 6.4: Payoffs in a special liability system

Considering the pure strategy Nash equilibria as before, it can be seen that the pairs (NR, R) and (R, NR) are not Nash equilibria, and the pair (R, R) is a Nash

[17] It could be that $D_R + D_{NR} \geqslant 2D$. If this is the case, the special liability rules ensure that claimants can still obtain full compensation for their harm.

equilibrium regardless of the values of the parameters. The pair (NR, NR) is a pay-off dominant Nash equilibrium if the following condition holds:

$$p < \frac{F_R + D_R}{F + D_{NR}} \tag{6.5}$$

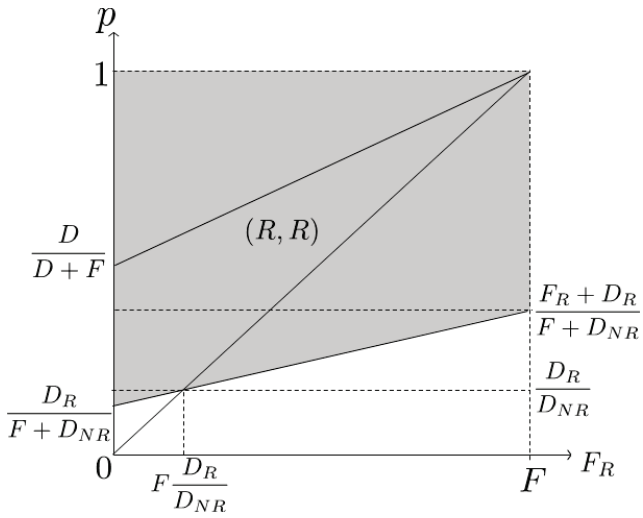
Only if the following condition holds is condition 6.5 stricter than the condition for (NR, NR) to be a pay-off dominant Nash equilibrium in a public enforcement system:

$$\frac{D_R}{D_{NR}} < \frac{F_R}{F} \tag{6.6}$$

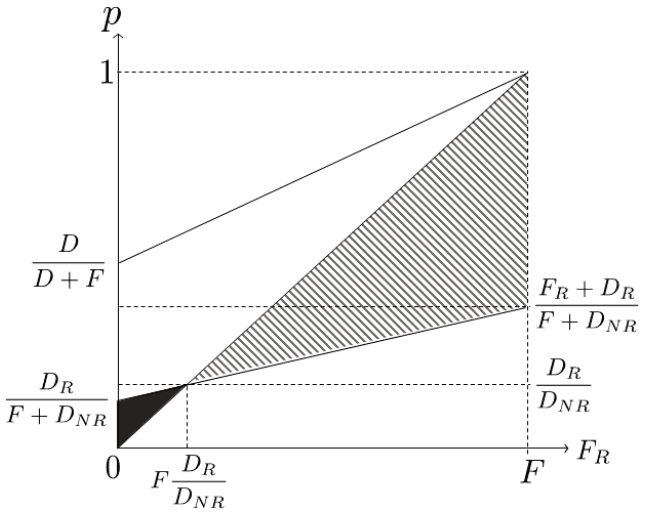
This means that a special liability system only induces more reporting than a public enforcement system if the reduction in damages is relatively larger than the reduction in fine that the immunity recipient obtains.

This is illustrated by Figures 6.3, 6.4 and 6.5.[18] Figures 6.3a, 6.4a and 6.5a show the (R, R) equilibrium for different combinations of the parameters, demonstrating how a special liability system compares to a public enforcement system. In the dark shaded areas, firms would report under a public enforcement system, but not under a special liability system. The striped shaded areas represent combinations of levels of the fines and damages for which firms would report under a special liability system, but not under a public enforcement system. Put differently, the dark shaded areas represent a reduction in reporting when a special liability system is introduced, whereas the striped shaded areas represent an increase in reporting.

[18] For a clarification see section C.1 in the Appendix.

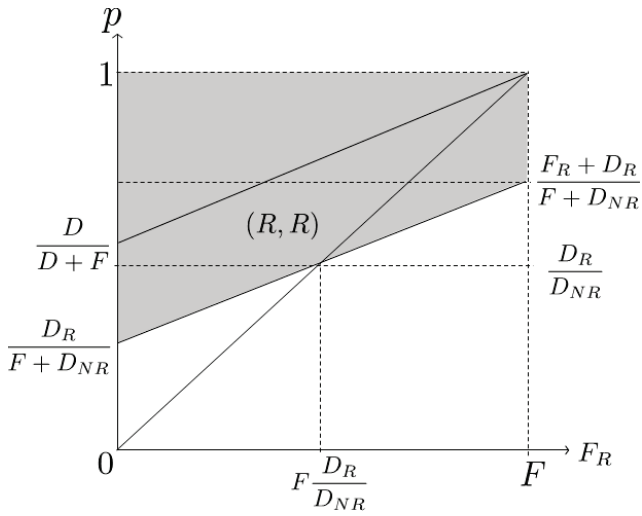


(a) Special liability system with $\frac{F}{D} < \frac{D_{NR}-D_R}{F+D_R}$

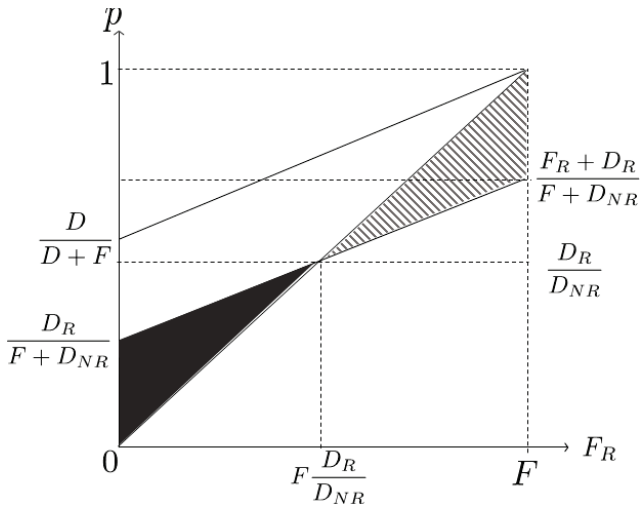


(b) Comparison to a public enforcement system

Figure 6.3: The equilibrium (R, R) in a special liability system for different values of p and F_R.

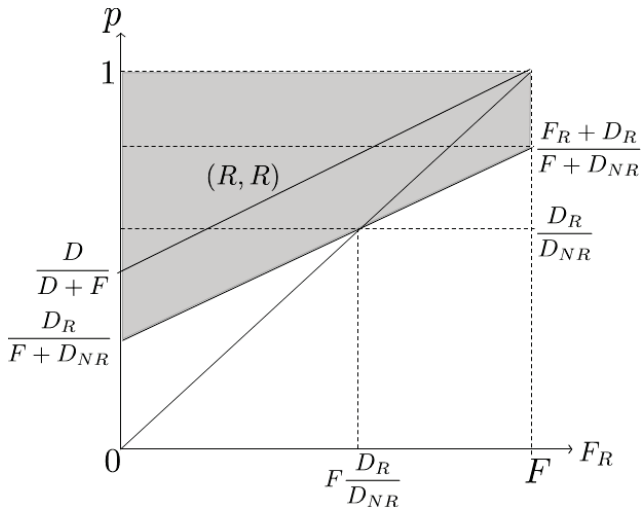


(a) Special liability system with $\frac{F}{D} > \frac{D_{NR} - D_R}{F + D_R}$

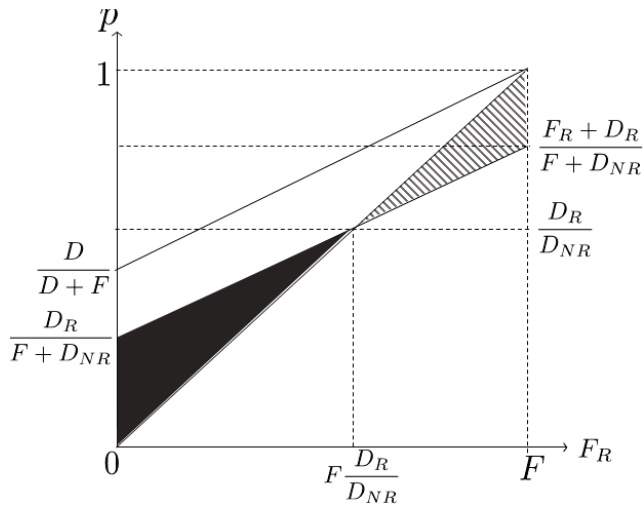


(b) Comparison to a public enforcement system

Figure 6.4: The equilibrium (R, R) in a special liability system for different values of p and F_R.



(a) Special liability system with $\frac{F}{D} < \frac{D_{NR} - D_R}{D_R}$



(b) Comparison to a public enforcement system

Figure 6.5: The equilibrium (R, R) in a special liability system for different values of p and F_R.

As can be seen from Figures 6.3b, 6.4b and 6.5b, a special liability system does not necessarily induce more reporting than a public enforcement system. This is

only true if the values of F, F_R, D_{NR} and D_R are such that the striped shaded area is larger than the dark shaded area. The higher the fine F for non-reporting firms, the more reporting a special liability system induces. Conversely, the lower the liability of immunity recipients as compared to the liability of non-reporting firms (i.e. the lower $\frac{D_R}{D_{NR}}$), the less beneficial the effect on reporting of introducing a special liability system.

Proposition 6.3. *A special liability system only induces more reporting than a public enforcement system if the following condition holds:*[19]

$$F - F_R + D_{NR} - D_R > \frac{D_R^2}{D_{NR}} \tag{6.7}$$

In sum, the effect of a special liability system depends on the relative values of F, F_R, D_{NR} and D_R: only if the costs faced by immunity recipients differ enough from the costs faced by non-reporting firms, does a special liability system induce more reporting than a public enforcement system. Essentially, the more closely the special liability rules resemble an exemption system, the more positive the effect will be on reporting.

6.4 Evaluating U.S. and EU liability rules

The previous section has demonstrated that special liability rules do not necessarily induce more reporting than a normal liability system. This section assesses the impact on reporting of the special liability rules applicable in the U.S. and the EU.[20] As will be discussed, there are remarkable differences between the applicable rules regarding liability in the EU and the U.S.[21] After a description of

[19] The proof can be found in section C.2 in the Appendix.

[20] For a general comparative analysis of EU and U.S. competition policies, see e.g. Bartalevich (2014).

[21] Another markable difference concerns the possibility for class actions in the U.S., towards which there is a great aversion in Europe. The scepticism is due to alleged abuses and the

the applicable rules, a numerical example is presented in order to illustrate their likely impact on the leniency program. The findings are placed into perspective with a discussion of the goals of antitrust enforcement in both jurisdictions, and the goals of the EU Antitrust Damages Directive in particular.

6.4.1 Liability rules in the U.S. and the EU

In the American antitrust system private antitrust litigation plays a central role, as illustrated by the fact that over 90 per cent of all antitrust proceedings are brought before the courts by individuals or entities.[22] Over the years, at least $18-19 billion in damages is estimated to have been recovered by victims of cartels (Lande, 2012).

The possibility of private antitrust enforcement was first introduced in s.7 of the U.S. Sherman Act of 1890.[23] The Sherman Act has been superseded by the Clayton Act of 1914, which is similar in content.[24] Every U.S. state has passed an antitrust statute that is comparable to the Sherman Act or the Clayton Act.

In relation to liability of colluding firms, three rules are particularly relevant:

- **Punitive damages:** First, the U.S. system allows injured parties to obtain punitive damages: three times the damages an injured party actually sustained, therefore also called *treble damages*.[25] Civil courts automatically award treble damages, providing a large incentive for private litigants to bring their claims Immunity recipients are exempted from the rules on tre-

concern that attorneys act in their own interest, rather than in the interest of the claimants. On class actions and the problems of organising collective claims by other means, see e.g. Van den Bergh (2013).

22 Source book of Criminal Justice Statistics, table 5.41.2012. Available via `http://www.albany.edu/sourcebook/`. See also Terhechte (2011, 26).

23 Act to protect trade and commerce against unlawful restraints and monopolies, ch.647,26 Sta, 730 (1914) ('Sherman Act').

24 Act to supplement existing laws against unlawful Restraints and Monopolies, and for other purposes, ch.323, 38 Stat. 730 (1914) ('Clayton Act').

25 Section 15a, paragraph 4 of the Clayton Act.

ble damages.[26] The prospect of being able to obtain treble damages may lead claimants to target non-reporting firms, making them a more attractive target for claimants than the immunity recipient (Dabbah, 2010; Scharaw, 2014, 355).

- **Joint and several liability:** The second relevant aspect is the rule on *joint and several liability*, which specifies that any cartel member can be sued for the entire harm of the cartel. In combination with the treble damages rule, this means that a colluding firm faces a liability of three times the harm of the cartel. A special rule is in place for the immunity recipient, who is only liable for single damages based on its own sales.[27] In short, under the U.S. rules the immunity recipient can obtain relief from treble damages and from joint and several liability faced by all other participants in the cartel.

- **Contribution:** On top of that, defendants do not have a right to claim contribution from the other cartel members. This means that if a cartel participant, other than the immunity recipient, is sued by injured parties, it ends up paying for the entire amount of the damages.

In the EU, private antitrust litigation is a more recent and less developed phenomenon, although Germany, the United Kingdom and the Netherlands have seen a high number of antitrust damages cases in the last decade.[28] The Antitrust Damages Directive adopted in 2014 stipulates special liability rules for immunity recipients:[29]

[26] Section 213(a) of the Antitrust Criminal Penalty Enhancement and Reform Act of 2004. Before the enactment of this law in 2004, self-reporting firms were also liable for treble damages.

[27] Antitrust Criminal Penalty Enhancement and Reform Act of 2004 Pub L No 108-237, 118 STAT 661 (2004), amended by PUB L No 111-90, 124 STAT 1275 (2010). See further Scharaw (2014, 356) and Baker (2012, 259).

[28] See footnote 2 above.

[29] In addition to the special liability rules, the Directive also stipulates limits to the access that claimants have to leniency documents and other sensitive information with the aim of preserving the incentives of cartel members to apply for leniency (Articles 5-8 of the Directive). While these rules may have a bearing on the liability of immunity recipient, they

- **Punitive damages:** The Directive does not allow for punitive damages.[30] This rule follows the applicable rule in almost all European Member States. In the few states that allow for the award of punitive damages, such as the United Kingdom, Ireland and Cyprus, they are rarely awarded (Scharaw, 2014, 355; Waelbroeck et al., 2004, 84).

- **Joint and several liability:** Cartel participants are liable for the entire harm of the cartel. The immunity recipient, in contrast, is only liable towards its own direct and indirect purchasers.[31] However, the Directive specifies exceptions to this situation:

  1. Small firms exception: Small and medium-sized firms are exempted from joint and several liability.[32]

  2. Inability to pay exception: The immunity recipient is still liable for all harm caused by the cartel if the other defendants are unable to offer compensation to injured parties.[33]

do not relieve the immunity recipient from (part of) its liability. At most, the limitations to disclosure ensure that immunity recipients are not in a worse position than cartel participants that did not cooperate under the leniency program. These rules are therefore not further treated in this chapter. For a full discussion of the interplay between disclosure rules and incentives to apply for leniency, see further (Guttuso, 2014b; Peyer, 2013; Peyer, 2015.

30 Article 2 paragraph 3 of the Directive specifies that 'Full compensation under this Directive shall not lead to overcompensation, whether by means of punitive, multiple or other types of damages'.

31 Article 11 of the Antitrust Damages Directive.

32 The reasons are that it is deemed unfair if small firms would have to recover the entire harm of the cartel, and it is feared that this might lead to bankruptcies. This exception is not treated in this chapter. Analysing the impact of this rule in a setting with asymmetric firms would be a possible extension of the game-theoretic analysis presented above.

33 Article 11, paragraph 4 under b of the Directive. At least two scenarios come to mind in which this situation could occur. The first is if the other cartel participants have gone bankrupt, possibly after having paid the public fine. Although there are no known cases of bankruptcy following antitrust fines, the fines are regularly reduced on grounds of bankruptcy concerns. This was for example the case for five of the seventeen firms involved in the bathroom equipment cartel. See the EU press release 'Antitrust: Commission fines 17 bathroom equipment manufacturers EUR 622 million in price fixing cartel' (IP/10/790) and Fabra and Motta (2013). Secondly, it is possible that an appeal court overturns the sanctioning decision with respect to some or all of the co-defendants. This would make it impossible for injured parties to claim a contribution from the other cartel participants - which then technically are not participants - leaving the immunity recipient exposed to

In short, under the EU system the immunity recipient is not in all circumstances relieved from joint and several liability for the entire harm of the cartel.

- **Contribution:** The EU Directive permits defendants to sue co-defendants for a contribution based on their responsibility for the harm.[34]

	U.S.		**EU**	
	Non-reporting participants	*Immunity recipient*	*Non-reporting participants*	*Immunity recipient*
Punitive damages	Yes	No	No	
Joint and several liability	Yes	No	Yes, unless small firm	No, unless others are unable to pay
Contribution	No		Yes	
Public fine	Maximum twice the cartel gain/harm if > $100 mln		Maximum 10% of total turnover in affected market	

Table 6.5: Liability rules for antitrust damages actions in the U.S. and the EU

Table 6.5 summarises how the special liability rules applicable in the U.S. and the EU compare. The table also includes the rules on antitrust fines in both jurisdictions. In the U.S., the maximum fine may be increased to twice the amount the conspirators gained from the illegal acts or twice the money lost by the victims of the crime, if either of those amounts is over $100 million.[35] In the EU, a cartel

liability for all cartel harm. The immunity recipient cannot deny its involvement in the cartel after having admitted the infringements to the CA. With Commission decisions being binding in civil court, this leaves the immunity recipient in a vulnerable position. See also Geradin and Grelier (2014) and Akman (2014).

[34] See Article 11, paragraph 5 of the Directive. Discussion is ongoing about the precise meaning of 'responsibility for the harm'. It is unclear whether it should be interpreted as sales or market share, or rather as the role of the firm in the anti-competitive behaviour.

[35] Sherman Act and Federal Trade Commission Act 2006. In contrast to the EU, employees

participant faces a maximum fine equal to 10% of the sum of the total turnover of each member active in the market affected by that infringement.[36]

6.4.2 A numerical example

This subsection presents a numerical example, with the aim of illustrating how the special liability rules of the U.S. and the EU compare in terms of their effect on incentives to apply for leniency. The numerical example does not extend the model presented in section 6.3, but is used to interpret the meaning of these results in light of the U.S. and EU private antitrust enforcement systems.

In order to compare how much firms will pay in fines and damages when a cartel that they were part of is revealed, one needs to know the profit made by the cartel, the turnover of the cartel on the market affected by the cartel, and the worldwide turnover of the firm. A hypothetical case is considered in which two symmetrical firms formed a cartel that drove up prices. The amounts were chosen based on an inquiry into a number of EU cartel cases, in order to estimate realistic values for the turnover and profit.[37] The firms are assumed to have made a profit of EUR 600 million. For simplicity, it is assumed that marginal costs equal zero, and the firms would have made no profits if they would have competed with each other. Therefore, the cartel profit equals turnover of the cartel. For the fine calculations in the EU, not only the turnover of the cartel is relevant, but the total turnover in the 'affected market'.[38] Consider that the turnover of both firms in the market

of U.S. cartel participants also risk criminal prosecution for their involvement in the cartel. The Sherman Act imposes criminal penalties of up to $1 million for an individual, along with up to 10 years in prison. This feature of the American public antitrust enforcement system is not treated in the numerical example, although it clearly has important implications for the functioning of the leniency program. As will be seen in the following, however, it only offers further support for the findings in this chapter.

[36] Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003, para. 33. The amount of the fine may be adjusted where the Commission finds that there are aggravating or mitigating circumstances (paragraph 27 e.f.).

[37] An overview of recent cartel decisions by the EU Commission can be found on `http://ec.europa.eu/competition/cartels/cases/cases.html`.

[38] The Fining Guidelines for the European Commission state that, in order to determine the fine to be imposed, the European Commission is not obliged to take into account only sales

affected by the cartel equals EUR 2 billion each, thus exceeding the turnover and profits made by the cartel itself.

It is difficult to estimate the probability of detection of cartels given that we do not have information on the entire set of cartels, but only those which have been detected. The few studies that have been conducted, however, estimate the detection probability to be very low.[39] It is assumed here that the probability of detection is 20%.

	U.S.		**EU**	
	Non-reporting firm	Immunity recipient	Non-reporting firm	Immunity recipient
Public fine	$F = 1200$ (2×600)	$F_R = 0$	$F = 260$ $(\frac{1}{10} \times (600+2000))$	$F_R = 0$
Civil damages	$D_{NR} = 2700$ $(3 \times \frac{1}{2}(1200+600))$	$D_R = 300$ $(\frac{1}{2}(600+0))$	$D_{NR} = 600$	$D_R = 600$

Table 6.6: Numerical example

In this setting, the fine and liability of the immunity recipient and the non-reporting firm are as depicted in Table 6.6, with between parentheses the calculations for the amounts. As can be seen from Table 6.6, the public fine is much higher in the U.S. than in the EU. This is partly due to the assumption that turnover equals profit and consumer harm: if production costs are substantial, the U.S. and the EU fines will be closer together. At the same time, the as-

for which there is evidence that they were actually affected by the cartel. Rather, all sales made in the market affected by the cartel may be taken into account. See recital 33 of the Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003, OJ C210/2.

[39] Very few studies are available on the subject of the probability of detection of cartels. The first study is by Bryant and Eckard (1991), who estimated a detection probability of 13% to 17% based on an American sample of cartels detected between 1961 and 1988. As their sample consists only of convicted cartels, the estimation concerns the annual probability of getting caught for cartels *that will eventually be detected*, not the global detection probability. Combe et al. (2008) estimate this conditional detection probability over a European sample, finding an annual probability between 12.9% and 13.3%. The authors based their estimation on the sample of all cartels convicted by the European Commission from 1969 to 2008.

sumption of EUR 2 billion in turnover beyond the cartel profits inflates the EU fine. For some firms, that operate mostly locally, this assumption that turnover in the affected market exceeds three times the cartel turnover may be overstated. Nevertheless, a quick scan of the cartels that were convicted over the last decade shows that often large multinational companies are involved.

Regarding the civil liability of cartel participants, the difference between the U.S. and the EU are striking. Leaving possibilities of bankruptcy aside, a non-reporting conspirator in the EU faces the same liability as the immunity recipient. The reasons are as follows. Although the rule on joint and several liability only applies to the non-reporting firm, the contribution rule allows the non-reporting firm to sue the immunity recipient for its share of the harm. As a result, the damages payments are redistributed over the cartel participants.

In the U.S., in contrast, cartel participants do not have the right to sue other conspirators for a contribution. In combination with the joint and several liability rule, this implies in this two-firm example that a non-reporting cartel participant faces a twice as high liability as the immunity recipient. Namely, the immunity recipient faces either liability for its own share of the harm (if it is sued first by the claimant), or relieved from liability (if the non-reporting conspirator is sued first). This is different for the non-reporting conspirator, who faces either liability for the entire cartel harm (if it is sued first) or liability for its own share of the harm (if the immunity recipient was sued first, from which only part of the harm could be recovered).

The difference is amplified by the rule on punitive damages in the U.S., trebling the liability of non-reporting conspirators but not that of the immunity recipient. In the EU, instead, punitive damages are not permitted.

Overall, in a two-firm example the liability of a U.S. cartel participant that did not report the cartel is a factor nine times as high as that of the immunity recipient. In the EU, by contrast, both face the same civil liability. This means that the EU system essentially resembles a normal liability system, which reduces incentives to report as compared to a system without liability (see proposition 6.1 in section

6.3). In short, facilitating private enforcement in the EU in this way is liable to undermine the leniency program.

6.4.3 When do the special liability systems induce reporting?

Section 6.3 demonstrated that a special liability system can induce more reporting than a system without private enforcement, if the civil liability of the immunity recipient is sufficiently small as compared to that of non-reporting cartel participants (see proposition 6.3 in section 6.3). The question is whether this is the case in the EU and U.S., for this numerical example. The matrices in Tables 6.7 and 6.8 depict the payoffs of cartel participants in the U.S. and the EU for the numerical example presented above.

		Firm 2	
		Report (R)	**Not report (NR)**
Firm 1	**Report (R)**	**2100** ; **2100** ($\frac{1}{2}$(1200 + 2700 + 300))	**300** ; **3900** (0+300 ; 1200+2700)
	Not report (NR)	**3900** ; **300** (1200+2700 ; 0+300)	**780** ; **780** ($\frac{1}{5} \times (1200 + 2700)$)

Table 6.7: U.S., numerical example

The pay-off matrix in Table 6.7 depicts the payoffs of reporting and not reporting in the U.S. and EU enforcement systems, with between parentheses the calculations for the payoffs. As can be seen from Table 6.7, the U.S. enforcement system induces reporting in this numerical example. The pair (NR, NR) is not a Nash equilibrium, since either firm can improve its pay-off by choosing to report. The pair (R, R) is a Nash equilibrium, because neither firm can gain from not reporting if the other firm reports. Filling in the pay-offs into the condition from proposition 6.3 yields the following:

$$F - F_R + D_{NR} - D_R > \frac{D_R^2}{D_{NR}}$$

$$1200 - 0 + 2700 - 300 > \frac{200^2}{2700}$$

$$3600 > \frac{100}{3}$$

The left-hand side of the equation exceeds the right-hand side, meaning that the special liability rules in the U.S. induce more reporting than a similar system in which cartel members would only have to pay the public fine.

		Firm 2	
		Report (R)	**Not report (NR)**
Firm 1	**Report (R)**	**730** ; **730** $(\frac{1}{2}(260 + 600 + 600))$	**600** ; **860** $(0 + 600 \; ; \; 260 + 600)$
	Not report (NR)	**860** ; **600** $(260 + 600 \; ; \; 0 + 600)$	**172** ; **172** $(0.2 \cdot (260 + 600))$

Table 6.8: EU, numerical example

As the second pay-off matrix, depicted in Table 6.8, shows, under the EU liability rules (NR, NR) is a Nash equilibrium in our numerical example. The pair (R, R) is a Nash equilibrium too, but the non-reporting equilibrium is pay-off dominant. This is not surprising, as we have seen that the EU system resembles a normal liability system. It does not meet the criterion of proposition 6.3, meaning that the same system without liability to pay damages would induce more reporting:

$$F - F_R + D_{NR} - D_R > \frac{D_R^2}{D_{NR}}$$

$$260 - 0 + 600 - 600 < \frac{600^2}{600}$$

$$260 < 600$$

That leaves the question of which adjustment to the civil liability of the immunity recipient and (or) non-reporting conspirators would be sufficient to induce more reporting than the same system without private enforcement. Several options are possible to achieve this:

1. **Shifting some liability from the immunity recipient to the non-reporting firm.** If the immunity recipient is relieved from part of the damages liability, and this part is shifted to the non-reporting firm, in this numerical example a shift of 12.5% of the liability would be needed to achieve more reporting (600 to 252 and 600 to 675 for the immunity recipient and the non-reporting firm respectively):

$$260 + 675 - 525 > \frac{525^2}{675}$$

$$410 > 408.3..$$

   The total damages paid to injured parties still equals 1200, just as in the normal liability system.

2. **Reducing the liability of the immunity recipient.** If the immunity recipient is relieved from part of the damages but this part is not paid by the non-reporting firm, in this numerical example a reduction of more than 20% of the liability would be needed to achieve more reporting (from 600 to roughly 478):

$$260 + 600 - 478 > \frac{478^2}{600}$$
$$382 > 380.8..$$

This solution is unattractive from a compensation perspective, since not all losses are covered by the cartel participants (only 1078, less than 90% of the total amount of the harm).

3. **Increasing the liability of the non-reporting firm.** If the liability of the non-reporting firm is increased without the immunity recipient obtaining a discount, a minimum increase of over 32% (600 to 794) would be needed in this numerical example to achieve more reporting:

$$260 + 794 - 600 > \frac{600^2}{794}$$
$$454 > 453.4..$$

6.4.4 Goals of antitrust enforcement

As the previous sections have illustrated, the special liability rules for immunity recipients in the Antitrust Damages Directive may not be appropriate to preserve incentives for conspirators to report a cartel under the leniency program. Previous contributions have already highlighted that the Directive may not optimally balance public and private antitrust enforcement. Cauffman (2011) therefore suggests exempting the immunity recipient from civil liability, unless injured parties cannot obtain compensation from the other cartel participants. Another reason why such an exemption may be warranted is that the immunity recipient is arguably the most attractive target for litigation. Since it is likely to be the only cartel participant not to appeal the competition authority's decision, it is the first that injured parties can sue with the back-up of a final decision of the competition

authority (Geradin and Grelier, 2014; Guttuso, 2014a).[40]

One might ask why the rules on liability in the Directive were drafted in this way, considering these problems. The main reason can be found in the objective of private enforcement in the EU, which is, primarily, to ensure compensation of harm caused by antitrust infringements.

During the process of adoption of the Directive, the goal of private antitrust enforcement was not always as unequivocal. Where the Green Paper stated that civil liability contributes to 'more effective deterrence from entering into cartels',[41] the deterrence-terminology largely disappeared in the White Paper, which named compensation of antitrust harm as the primary goal but still stated that 'Improving compensatory justice would [...] inherently also produce beneficial effects in terms of deterrence of future infringements'.[42] After critical reactions to the interplay between damages actions and the leniency program, this wording was not used in the Directive. Instead, next to ensuring the full compensation of harm due to competition law infringements, the Directive aims to balance public and private enforcement of competition law.[43]

The focus on compensation reflects the essence of the *Courage v Crehan* judgement that started the private antitrust enforcement debate in the EU.[44] In this case, the European Court of Justice held that parties injured by anti-competitive conduct should have the right to seek compensation for their harm. The Ashurst study,

[40] Other critique regarding the joint and several liability rules concerns the ambiguity of the provisions. It is not clear whether the liability of the immunity recipient extends to all the harm of its own purchasers, or only to the harm caused by its sales to these purchasers (Wisking et al., 2014). Another source of ambiguity is the exception of joint and several liability for small and medium sized companies, since defendants may initially not know whether this exception applies to them (Peyer, 2015). Commentators have also criticized the liability provisions, in particular the possibility of contribution proceedings, for their potential negative effect on settlements (Kortmann and Wesseling, 2013).

[41] European Commission, Green Paper on damages actions for breach of the EC antitrust rules, COM(2005) 672, 19 December 2005, p. 9.

[42] European Commission, White Paper on actions for breach of the EC antitrust rules, COM(2008) 164, 2 April 2008, p. 3.

[43] Directive, preamble. See also the Proposal for a Directive on Antitrust Damages Actions COM(2013) 404 final, p. 3.

[44] Case C-453/99 *Courage v Crehan* [2001] ECR I-06297.

conducted to obtain an overview of the possibilities for injured parties to file antitrust damages actions, concluded that the landscape of private enforcement in the EU showed 'astonishing diversity' and 'total underdevelopment' (Waelbroeck et al., 2004, 1). The Ashurst study found that legal rules governing civil damages actions were one of the obstacles to potential claimants.

The policy papers drafted by the European Commission to remove these obstacles spurred a vigorous debate on the role that private enforcement should play in the EU. It was argued that public enforcement is a more effective and efficient mechanism to achieve deterrence than private litigation (Van den Bergh and Keske, 2007), and it was questioned whether there is a social need for antitrust damages actions to begin with (Wils, 2003; Rosch, 2011b). Moreover, achieving corrective justice for antitrust harm would be a very difficult task in practice (Wils, 2003). In addition, concerns were raised as to how the EU would avoid the undesirable side effects of private enforcement experienced in the U.S., such as frivolous law suits and litigation favouring attorneys rather than the injured parties (Ginsburg, 2005; McCarthy et al., 2007). Many of the U.S. rules (e.g. on punitive damages and contingency fees) were deemed incompatible with European civil law traditions.[45] The challenge in the EU, it was argued, was to encourage private damages claims while avoiding these pitfalls (Rosch, 2011a). Finally, commentators warned that the interplay of private enforcement with the leniency program deserved more attention (MacCulloch and Wardhaugh, 2012; Van den Bergh and Keske, 2007; Rosch, 2011b). Regardless of the goal of private enforcement, conflicts with the effectiveness of public antitrust enforcement could arise and should be resolved as much as possible.[46]

In short, the design of the Directive is the result of an extensive weighing exercise between various policy goals. The primary policy goals chosen in the EU are reflected in the rules that have been adopted. The rule allowing contribution

[45] See e.g. the statement of European Commissioner for Consumer Protection Meglena Kuneva at that time, that there would not be any U.S.-style class actions in Europe (M. Kuneva, 'Healthy Markets Need Effective Redress', speech Lisbon, 10 November 2007).

[46] See also Lowe and Marquis (2014) on the various issues related to balancing public and private antitrust enforcement.

proceedings is in line with the goal of compensation, since a prohibition would add a punitive element to the damages payments, which would then exceed the actual harm of the anti-competitive conduct. Similarly, punitive damages would turn private enforcement into an additional sanction for cartel participants. In combination with the contribution rule, joint and several liability is compatible with the compensatory goal as well, as it simply functions as a tool to simplify litigation for claimants without increasing damages payments of the defendants beyond the actual harm they caused.

Notwithstanding that the rules in the Directive serve the compensatory goal, the second goal of the Directive, to balance public and private enforcement, may not have been given sufficient attention. In the U.S., in contrast, the liability rules clearly serve the deterrence goal, ensuring that leniency incentives are safeguarded by substantially reducing the liability of immunity recipients as compared to non-cooperating cartel participants. However, the U.S. system on its part has been criticized because not consumers but law firms would benefit most from it.[47] Other criticisms include that the high damages payments would provide a too large incentive to sue, resulting in unmeritorious lawsuits and blackmail settlements (Calabresi, 2012; Scherer, 2012).[48]

The U.S. experience indeed provides an argument against importing the U.S. liability rules to the EU in their entirety, besides the objections from the perspective of the European civil law traditions. Ultimately, it may not be possible to achieve both full compensation and an optimally functioning leniency program without introducing some type of punitive damages for non-cooperating cartel participants. Even the 'mildest' solution put forward in this chapter, to shift part of the liability of the immunity recipient to the non-cooperating conspirators, would amount to damages payments that exceed the actual harm caused by these firms. Put differently, it may be necessary to compromise on at least one of the policy goals.

[47] See e.g. Mcquillan and Archie (2007).

[48] See also the preamble of the Class Actions Fairness Act, which was passed by the U.S. Congress in 2005, Public Law 109-2, 119 Stat. 4 (February 2005). Nevertheless, more recently commentators have put forward a more nuanced view of the U.S. private antitrust litigation. See e.g. Lande (2014).

6.5 Conclusion

This chapter has addressed the question of how much the special liability rules for immunity recipients in the new Directive on Antitrust Damages Actions preserve incentives for cartel members to apply for leniency, when compared to the rules applicable in the U.S. While both jurisdictions aim to strike a balance between private damages actions and preserving the leniency program, the systems differ markedly in the special liability rules available for immunity recipients.

Using a game theoretic approach, this chapter illustrated that private antitrust enforcement may undermine incentives to apply for leniency. This finding is similar to previous models on the tension between damages and the leniency program, which primarily focused on the benefits for the leniency program of exempting the immunity recipient. This chapter aimed to contribute to the literature by also considering an alternative way to preserve incentives to report the cartel: not necessarily by exempting the immunity recipient, but more generally by creating a difference in liability between the immunity recipient and non-reporting firms. This does not necessarily imply exempting the immunity recipient, but could also mean that the non-reporting firms pay a larger share in damages than the actual harm they caused.

Various rules in the U.S. and the EU that apply specifically to immunity recipients are aimed at creating such a difference. This chapter demonstrated that these special liability rules only enhance the incentive to report a cartel if the difference in liability of the immunity recipient and non-cooperating cartel participants is sufficiently large. Next, the chapter examined how the U.S. and EU special liability rules 'perform' in light of this result. It was found that the special liability rules in the Directive do not create a substantial difference in liability between the immunity recipient and non-reporting firms. Placing these rules in their context, the chapter found that the rules in the Directive reflect the compensatory goal of private enforcement in the EU. Nevertheless, these rules could have the unintended effect of undermining incentives to report cartels under the leniency program. This is problematic for the compensatory goal as well, since

most antitrust damages actions are follow-on claims that rely on a decision by the competition authority.

Consequently, in order to balance public and private antitrust enforcement, an adjustment to the liability rules in the Directive may be warranted. Several options were discussed, but all seem politically unattainable. Abandoning the contribution rule or introducing treble damages would further the goal of balancing public and private enforcement, but imply that firms will be liable for damages that far exceed the actual harm that was caused. Such a punitive element to civil liability is not familiar to most EU civil law systems. The alternative, to exempt the liability of the immunity recipient, may also be resisted from a moral perspective, because it lets an antitrust violator completely 'off the hook'. A solution may be found in the proposal of Cauffman (2011), to adopt the Hungarian approach of relieving immunity recipients from liability as long as the claim can be collected from other cartel participants.

As this chapter aimed to demonstrate, a full exemption from liability may not even be necessary to maintain incentives to apply for leniency. A shift of only part of the liability from the immunity recipient to the non-cooperating firms could be sufficient. In combination with a provision leaving the immunity recipient as a 'last resort' if the claim cannot be collected from the other cartel participants, the goal of full compensation would be ensured as well.

Chapter 7

Conclusions

This thesis aimed to clarify the relevant considerations for harmonisation of rules of private law to improve the functioning of the EU internal market. The research aimed to contribute to the literature by presenting a law and economics framework to determine whether and how much harmonisation of aspects of private law is necessary and desirable for the improvement of the internal market. The broader societal relevance of the research was to contribute to better EU policy making, meaning policy making on the basis of clear welfare considerations.

This concluding chapter presents an overview of the findings in this thesis, and provides the implications of these findings for EU policy making. The legal requirements for harmonisation enshrined in the limits to the internal market's legal basis and the principles of subsidiarity and proportionality are inspected against the background of the economic considerations discussed in this thesis. A more inclusive test is presented in the form of a 'check list' for policy making for the internal market, which includes these various considerations. This is not to say that this research provides a final answer to the question of optimal harmonisation for the internal market. Therefore, possible avenues for future research in this area are discussed.

7.1 General observations

The thesis identified that, currently, EU measures based on the legislative competence for the internal market are often justified with the argument that legal differences create transaction costs and thus form an internal market barrier. The problem of defining legal diversity itself as an obstacle to the internal market is that it turns the subsidiarity test into a 'paper tiger': a test that will by definition find in favour of harmonisation. The reason is that if reducing differences between legal rules is considered to be the objective of harmonisation, it is obvious that the EU legislator is better able to achieve this objective than the Member States, and therefore, that EU action is needed.

Indeed, several Impact Assessments for EU measures based on the legislative competence for the internal market illustrated that compliance with subsidiarity and proportionality is not demonstrated convincingly. These policy documents merely assert that the principles have been complied with, rather than explaining why the objectives of the proposed measures cannot be sufficiently achieved by the Member States, and why they can be better achieved at Union level. This is not surprising since the argument that harmonisation is necessary in order to reduce legal differences is essentially circular, and does not require much explanation. Nevertheless, this application of subsidiarity and proportionality does not reflect the purpose of these principles: to curtail the exercise of EU competences by the EU institutions.

The role that subsidiarity and proportionality can play is particularly limited in the context of harmonisation based on the legislative competence for the internal market. This is a result of the way in which Article 114 TFEU is defined. This legal basis is stated in terms of its objective of improving the internal market, rather than achieving a particular political goal, such as consumer protection or competition law enforcement. While Member States can achieve particular political goals on their own, it is hard to imagine them achieving the goal of harmonisation of rules better than the EU.

This thesis explained why it is a problem that the European Courts have given

the EU institutions a wide discretion in their reliance on Article 114 TFEU for harmonisation, and have been reluctant to thoroughly review the compliance of legislative proposals with subsidiarity and proportionality. The very wide limits to Article 114 TFEU are problematic in light of the principle that the EU only has the competences that have been conferred upon it: if a competence can be used to harmonise almost all rules, this principle is devoid of meaning in practice. More explanation is required as to why it is problematic that the Courts leave the EU institutions a wide discretion as regards the principles of subsidiarity and proportionality. One may argue that it is sufficient that the Commission acts within the limits of a legislative competence, and that the European Parliament and Council of Ministers have approved the legislative proposal. Chapter 2 explained why these limits alone are not sufficient. Several rationales for subsidiarity are distinguished in the legal literature: to prevent excessive harmonisation, to ensure that diversity remains where Member States value it, and to enhance the democratic legitimacy of EU policy making. In light of the societal concerns discussed at the outset of this thesis that EU integration might be going too far, each of these rationales is very relevant in the EU today. These rationales also reflect the welfare benefits of decentralisation found in much economic literature, as discussed in chapter 2. An important argument in favour of a decentralised system is, that it ensures that legal rules are responsive to the preferences of citizens. Consequently, a lack of scrutiny in the application of the subsidiarity and proportionality principles can be considered problematic.

Having identified shortcomings in the legal framework for harmonisation based on the internal market's legislative competence, the thesis proceeded to explore which additional considerations are relevant to determine the desirability of harmonising rules for the internal market. The next section discusses these findings and their relevance for policy making.

7.2 Summary of the findings

The thesis identified a number of relevant considerations in determining the desirability of harmonisation for the internal market, besides the transaction costs related to legal differences.

Chapter 2 stressed that in order to fulfil the rationales for subsidiarity - to safeguard against excessive EU power, promote diversity and ensure democratic legitimacy - subsidiarity should be a principle of economic efficiency, involving an analysis of the comparative benefits and costs of EU and Member State action. As a functional principle that informs policy makers of the welfare effects of harmonisation, subsidiarity could impose an enforceable limit to EU policy making.

Chapter 3 considered the particular legal requirements for harmonisation aimed at improving the internal market, and compared these to the specific economic arguments involved in harmonisation for this purpose. The chapter found that while the legal approach focusing on transaction costs finds support in the economic theory of integration, which highlights the benefits of integration on trade and competition, it is not in line with the broader welfare arguments included in the economic theory of federalism. The economic analysis reveals that neither economic theory is complete in its analysis of harmonisation for the internal market: the economic theory of integration fails to consider negative aspects of integration, while the economic theory of federalism overlooks the costs involved in a fragmented, uncompetitive market.

The first conclusion of the chapter is therefore, that an overarching economic analysis of integration needs to take account of the effects of integration on both obstacles to trade and competition in the internal market, and on heterogeneity in preferences and other broader welfare aspects of different levels of policy centralisation. Secondly, the considerations of economic federalism gain importance as integration progresses, because increasingly more positive harmonisation of laws is required, as opposed to merely taking down trade barriers. A third finding regarding the effect of harmonisation on trade is illustrated with the use of a Brander-Krugman trade model: not only should the differences between rules be

taken into account, but also the substance of the uniform rules that are to replace the national regulations. The reason is that the content of the applicable rules may represent obligations or benefits, for example to firms and consumers in the case of consumer protection rules. As a result, harmonising these rules may affect their decisions in the internal market not only through a reduction in transaction costs that existed due to legal differences, but also via costs of compliance with these rules, or benefits to be obtained from them.

In short, the first element in a Law and Economics 'check list' for harmonising rules to improve the internal market, besides transaction costs, is the relevance of the substance of the harmonised rules, and the costs and benefits it represents to the 'users' and beneficiaries of the law.

Chapter 4 built upon the findings in chapter 3, extending the analysis to include heterogeneous preferences of consumers. The chapter considered the question of how trade benefits compare to welfare benefits of harmonisation, using a vertical differentiation model. Against the background of the Consumer Rights Directive and the Digital Contract Directives, the chapter aimed to demonstrate that if consumers differ in their preferences for legal standards, harmonising rules does not necessarily improve welfare, even if it improves the functioning of the internal market as measured by trade. Harmonisation may involve a trade-off between enhancing competition and lowering prices by reducing transaction costs related to legal fragmentation, and diminishing the correspondence of rules to consumers' preferences by eliminating the variety of available rules. Therefore, it is relevant to verify whether harmonisation indeed reduces the costs of legal differences, and if it does, whether this this benefit justifies the reduced variety in policies in light of heterogeneous preferences across Member States.

In order to shed more light on the likely impact of full harmonisation of consumer contract rules on consumers' cross-border shopping behaviour, an empiric overview was compiled using data from EU consumer surveys. The findings of this empirical overview indicated that the applicable consumer protection rules may not be the decisive factor for consumers' cross-border shopping behaviour. The re-

spondents' cross-border shopping behaviour did not vary considerably depending on whether or not they feel protected by consumer protection rules, or whether or not they believe these rules can be easily enforced in court. However, cross-border shopping behaviour clearly differs between groups of respondents with different language skills, age, and other demographic and social characteristics. While further empirical research would be required to directly answer the question whether differences in legal rules form an obstacle for the consumer internal market, these findings do suggest that, in the view of consumers, the transaction cost savings from full harmonisation of consumer protection rules may be limited.

In sum, this chapter adds the importance of verifying the effect of harmonisation on transaction costs, and the relevance of heterogeneity in preferences to the 'check list' for harmonising rules to complete the internal market.

Chapter 5 and 6 examined specific aspects of the Antitrust Damages Directive. Chapter 5 evaluated the impact of harmonising the rules on limitation periods, in light of the the goal of providing a 'level playing field' for antitrust damages claims in the European Union. It was found that while the Directive will considerably reduce the variation in rules on limitation periods across Member States, variation is likely to remain as a result of different implementation by the Member States, unclear terms in the Directive that leave room for interpretation, and differences in rules that affect limitation periods but are not covered by the Directive. As a result, claimants will continue to face different rules depending on the Member State where they file their claim. Moreover, due to the fact that the scope of the Directive is limited to antitrust damages claims, claimants will also face different rules within a Member State depending on whether their claim relates to antitrust infringements or to other violations of the law. These conclusions have two implications. First, as long as claimants continue to face different rules across Member States, a level playing field for antitrust claims may not be fully achieved. As a result, some forum shopping may (still) occur. Secondly, if procedural rules start to diverge depending on the basis for claims, Member States' legal systems may lose their internal coherence and consistency. The more general lesson for harmonisation in the field of civil and procedural law is that the value of internally

coherent national legal systems should be taken into account when considering the introduction of further European initiatives containing procedural rules for specific areas.

Summarising, this chapter highlighted that the effects of harmonisation also depend on the scope of the European instrument, highlighting an additional element of the 'check list' for harmonising rules to complete the internal market besides the substance of these rules, and Member States' different preferences for rules on limitation periods.

Chapter 6 focused on the relevance of enforcement for the effects of harmonisation. In particular, it considered the interplay between public and private enforcement of competition law. The chapter analysed whether the harmonised rules on antitrust damages actions are likely to achieve the aim of the Antitrust Damages Directive to ensure full compensation of antitrust harm, against the background of the deterrence of anti-competitive behaviour by means of public enforcement. Using a game-theoretic approach, the chapter illustrated how private enforcement may reduce the attractiveness of the leniency program and thereby potentially undermine public enforcement. It also examined the extent to which the Directive succeeds at resolving the tension between public and private antitrust enforcement by stipulating special liability rules for firms that reported a cartel. A comparison with the U.S., where different rules on liability for damages apply, identified that the American rules may better protect the interests of reporting firms in order to preserve the leniency program than the rules in the Directive. Consequently, the second goal of the Antitrust Damages Directive - to balance public and private antitrust enforcement - may warrant an adjustment to the liability rules. Moreover, ultimately this would benefit the compensation objective as well, since the vast majority of private damages actions rely on a decision by an antitrust authority.

This chapter, in short, illustrated that both the substantial rules of a harmonisation measure and its enforcement need to be considered to determine the effects of harmonisation.

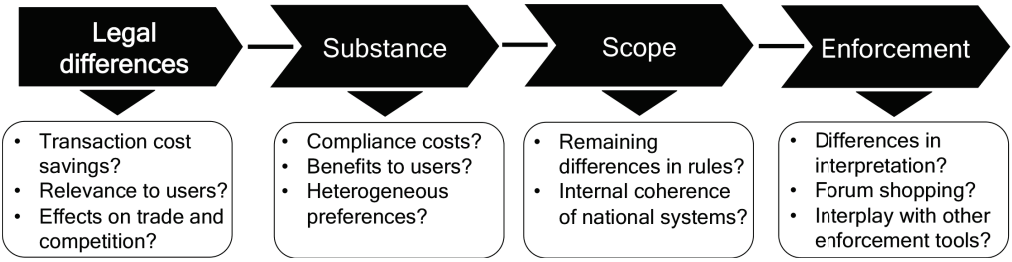


Figure 7.1: A Law and Economics 'check list' for internal market harmonisation

7.3 Policy implications

Each chapter in this thesis highlighted an aspect that, from a Law and Economics perspective, needs to be taken into account when determining the desirability of harmonisation that aims to improve the internal market. These aspects are summarised in Figure 7.1, which presents a 'check list' of factors to be considered to determine whether a harmonisation proposal is desirable.

It is acknowledged that this 'check list' is based on a Law and Economics analysis, and largely neglects other relevant aspects, such as strictly legal debates and political choices. Nevertheless, as has been stressed in this thesis, the aim is not to provide a final answer on harmonisation, but to offer a framework that may inform policy makers and underpin political choices. The thesis has highlighted tradeoffs in harmonising rules for the internal market. A rigorous application of a 'check list' of relevant factors would pressure policy makers to explicitly state these tradeoffs and explain why harmonisation is nevertheless desirable. This could contribute to the transparency and quality of EU policy, which could enhance the democratic legitimacy of EU policy making, and potentially help to convince citizens on the benefits of the EU.

The general implication for policy making of this research can thus be summarised as its emphasis on the need for rigorous and inclusive explanations of the need for EU harmonisation. Additionally, applying the 'check list' presented in Figure 7.1 by considering the questions in each step has several specific implications for

policy making.

The first step in this test is to examine whether harmonisation is likely to lower transaction costs. This involves the empirical question of whether legal differences form an obstacle to the users of the rules, such as consumers and firms for consumer contract rules. So far, the Commission has largely relied on data from surveys they conducted to establish that this is the case. This thesis found that the methods used in these surveys suffer from drawbacks, and that the results from these surveys do not provide very strong support for the claim that transaction costs for consumers when shopping abroad stem mainly from differences in consumer contract rules. Alternative empirical tools, such as studying actual shopping behaviour of consumers rather than asking about their motives and intentions, may be a preferable method for determining whether legal differences form an internal market obstacle. Nevertheless, the practical possibilities for such empirical research may be limited. A more careful design of surveys could also improve the empirical underpinnings of the claim of legal differences as internal market barriers. For example, the question whether consumers care about the level of consumer protection may be better answered by asking consumers factual questions regarding their knowledge of consumer contract rules, than by asking them whether they think they would purchase more abroad in the future if higher consumer protection standards applied. Additionally, it is relevant to ask consumers about other obstacles as well: if geographical distance, language differences and enforcement are the main problems, harmonising substantive consumer protection rules is unlikely to reduce transaction costs sufficiently to induce more cross-border shopping.

The second step in the test is to consider the costs and benefits that the substantive rules in the proposed measure entail for the users of these rules. If legal differences are important to these users, and impose transaction costs on them, they may also be concerned about the costs and benefits that the substance of these rules represent to them. If Member States' policies vary considerably, it is likely that there will be some 'losers' of harmonisation, for whom the EU standard represents fewer benefits or higher costs. Additionally, large divergences in rules

across Member States may reflect varying preferences for rules in this policy area. While it is unlikely that these costs and preferences could be mapped out empirically in detail, EU legislative proposals should at least consider how the changes in substantive rules may affect players in the internal market, and for what reasons policies may have varied in the first place. This thesis discussed the example of consumers, who may save transaction costs if consumer rules are harmonised, but who may face a lower level of consumer protection than they would prefer.

As a third step, consideration should be given to how the proposed legislation fits into the Member States' legal systems. One aspect of such a check is to verify whether the legislation leaves certain national rules untouched that may still be relevant for the users of these rules. A second is to consider the impact of introducing special rules for certain contracts, or claims, that set them apart from the general civil rules of Member States. More generally, the coherence of Member States' legal systems needs to be monitored. EU policy may only regulate law where it is specifically authorised by the Treaties. As a result, EU law takes a functional approach, regulating only certain topics rather than following the national dichotomy between public and private law, and other national classifications in the legal system. While each individual EU measure in the field of private law may not directly disrupt national legal systems, the development of 'piecemeal' harmonisation in this field may over time nevertheless disturb the coherence of Member States' private laws. Instead of examining this aspect on an ad hoc basis in each legislative proposal, it may be preferable to monitor this issue in a working group, or formulate a long term goal for private law in the EU.

Finally, the likely impact of EU legislative proposals needs to be assessed in light of their enforcement. For example, if rules are unclear or implemented in different ways, the harmonised rules may be enforced differently across Member States, undermining the goal of creating a level playing field and potentially leading to forum shopping. Moreover, the interplay with other enforcement tools needs to be considered, such as public enforcement by competition authorities or other regulators. In some cases, substantive rules may need to be reconsidered in order to ensure effective enforcement.

Returning to the requirements of the principles of subsidiarity and proportionality explained in chapter 2, it appears that not all of these considerations can be included in the current legal framework for harmonisation. The subsidiarity principle requires that EU action only takes place when i) the objectives of the proposed action cannot be sufficiently achieved by the Member States, and ii) the objective can be better achieved by the EU because of the scale or effects of the proposed action. The proportionality principle requires that the content and form of EU measures do not exceed what is necessary to achieve the objectives of the Treaties. In principle, these definitions leave room to take into account some of the considerations above, such as whether EU legislation can reduce transaction costs.

However, most of the considerations above have no place in these definitions of subsidiarity and proportionality. For example, there is no room for including the relevance of varying preferences or fragmentation of national legal systems. The reason is that the principles are formulated in terms of who is best placed to act, the EU or the Member States, given a set objective. The test does not question the validity of this objective. But as we have seen, in practice the objective of internal market proposals is often to reduce legal differences. In such cases, it is clear from the outset that the EU is best placed to act. If the test for harmonisation is to be a broader welfare test, including the considerations discussed above, the principles of subsidiarity and proportionality ought to ask not only who can best achieve the objective of the proposal, but also whether this objective reflects the broader goal of EU integration. This broader goal could for example be defined as maintaining a balance in the competences of the EU and its Member States in order to enhance the welfare of the citizens.

One might object that such a test should already have been met when the competence was conferred upon the EU, and that we should not repeat this exercise for every legislative act that is adopted. Indeed, an alternative may forward may be to set more clear limits to Article 114 TFEU, possibly by reviving the conditions stipulated by the Court in the *Tobacco Advertising* case, discussed in chapter 3.

In sum, there may be several ways to include the Law and Economics considerations presented in this thesis in the legal framework for harmonisation under the internal market's competence. It is clear, however, that a change in approach would be needed to include such a more rigorous test for harmonisation in EU policy making for the internal market.

7.4 Reflections and outlook

The topic of the desirability of harmonising rules to improve the internal market involves many questions. While this thesis has aimed to offer a more comprehensive framework for determining the need for harmonisation, it certainly did not answer all of these questions exhaustively. This final section reflects upon some limitations of this research and proposes avenues for future research in this area.

First, this thesis relied on trade models, game theory, comparative law and insights from theoretical economic literature on harmonisation. In order to shed more light on the relevance of each of the considerations for harmonisation identified in this thesis, more empirical research should be conducted. Chapter 4 aimed to take a first step in this direction by offering an empirical overview of consumers' attitudes towards consumer protection. Further empirical research could more thoroughly examine the relationship between cross-border shopping and consumer protection rules, as well as on firms' attitudes towards the applicable legal rules. With respect to other legal areas, empirical research could focus on whether harmonisation has resulted in market integration and intra-EU trade so far, and on the question of whether legal differences cause transaction costs to citizens and firms.

Secondly, some of the issues regarding the Directives discussed in this thesis require additional attention. For example, the thesis highlighted the relevance of enforcement, and the relation to the substantive rules in the EU legislation. In the context of the Antitrust Damages Directive, an issue that could be investigated further is how to ensure a coherent enforcement of the substantive rules on damages quantification and on the 'passing-on' of antitrust harm by buyers of

cartel members to their downstream customers. Recent experience in civil claims has illustrated that civil courts may rule differently on these matters. Varying interpretations on these issues could lead to unwanted forum shopping by litigants seeking the most 'plaintiff-friendly' forum. An important way forward may be the development of a European collective redress system. This is not only relevant for antitrust damages actions, but also for consumer claims. Since a EU collective redress system would entail the harmonisation of parts of Member States' procedural law, this again involves many of the questions that were discussed in this thesis, such as the internal coherence of Member States' legal systems, the potential for forum shopping and different preferences regarding the substantive rules for collective claims. Future research could examine to what extent the EU Recommendation on Collective Redress, published in 2013, addresses these issues, and lay out a fruitful way forward in this area.[1]

Finally, the thesis emphasised that the effects of harmonisation on the internal market depend not only on the uniformity of rules throughout the EU, but also on their substance. This means that the considerations for determining the desirability of harmonisation will vary depending on the legal area that is being harmonised. This thesis focused on specific EU Directives based on the legislative competence for the internal market. While the thesis certainly aimed to draw conclusions for harmonisation that have relevance outside the scope of these specific Directives as well, some aspects presented in Figure 7.1 may have more relevance than others in relation to other legal areas. For example, the aspect of compliance costs may be relatively important in relation to consumer protection policies, where it may affect decisions of consumers and traders to make use of the possibilities of the internal market, or rather to sell or buy nationally. The aspect of enforcement is likely to be relevant for most legal areas, but in different ways: in some we may need to be wary of forum shopping, whereas in others we need to take account of the enforcement activities of regulatory bodies. In order

[1] Commission Recommendation of 11 June 2013 on common principles for injunctive and compensatory collective redress mechanisms in the Member States concerning violations of rights granted under Union Law, OJ L 201, 26.7.2013.

to study the importance of these and additional effects of harmonisation, and to develop an overarching theory, future research is therefore welcomed on all legal areas affected by harmonisation based on the legislative competence for improving the internal market.

This research agenda would offer interesting and valuable insights for any policy area involving attempts at European harmonisation. Against the background of current developments and concerns about the direction of integration in the EU, this research agenda seems particularly timely. This thesis has sought to contribute results on several topics within this research area. In addition, whilst acknowledging that there are a number of disciplinary perspectives on such an agenda, it is hoped that the thesis has also helped to demonstrate the benefits of examining these topics using the tools of Law and Economics.

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Appendices

Appendix A

EU Consumer Law, Trade and Welfare

A.1 Questions Flash Eurobarometer Surveys "Consumer Attitudes Towards Cross-border Trade and Consumer Protection", waves 1-4

Online shopping behaviour			
Survey	**Year**	**Question**	**Answer format**
ZA5218	2009	Q1A. Please tell me if you have purchased any goods or services in the past 12 months, by distance in [your country] or elsewhere via the Internet (website, email, etc.)	1=Yes, from a seller/provider located in [your country], 2=Yes, from a seller/provider located in another EU country, 3=Yes, from a seller/provider located outside the EU,4=No, 9=[DK/NA]
ZA5466	2010	Q1. Please tell me if you have purchased any goods or services in the past 12 months, by distance in [your country] or elsewhere in any of the following ways?	1=Yes, from a seller/provider located in [your country], 2=Yes, from a seller/provider located in another EU country, 3=Yes, from a seller/provider located outside the EU, 4=No, 9=[DK/NA], and A. Via the Internet (website, email, etc.), B. By phone, C. By post (catalogues, mail order, etc.)
ZA5615	2011	Q1. In the past 12 months, have you purchased any goods or services, by Internet, phone or post in [your country] or elsewhere in any of the following ways?	1=Yes, from a seller/provider located in [your country], 2=Yes, from a seller/provider located in another EU country, 3=Yes, from a seller/provider located outside the EU, 4=No, 5=DK/NA and 1=Via the Internet (website, email, etc.), 2=By phone, 3=By post (catalogues, mail order, etc.)
ZA5793	2012	Q14. In the past 12 months, have you purchased any goods or services via the internet (website, email etc) in [your country] or elsewhere in any of the following ways?	1=Yes, from a retailer/provider located in [your country], 2=Yes, from a retailer/provider located in another EU country, 3=Yes, from a retailer/provider located outside the EU, 4=No, 5=DK/NA
ZA5943	2014	Q1. In the past 12 months, have you purchased any goods or services via the Internet?	1=Yes, from a retailer or service provider located in [your country], 2=Yes, from a retailer or service provider located in another EU country, 3=Yes, from a retailer or service provider located outside the EU, 4=No, 5=Yes, you purchased online but do not know where the retailer or service provider is located, 9=DK/NA

Table A.1: Online shopping behaviour

Attitudes towards laws and institutions			
Survey	**Year**	**Question**	**Answer format**
ZA5218	2009	Q10. For each of the following statements, please tell me if you agree or disagree with it. In [your country] A. It is easy to resolve disputes with sellers/providers through an arbitration, mediation or conciliation body (malfunctioning goods, late/ non-delivery, etc.) B. It is easy to resolve disputes with sellers/ providers through the courts C. You trust independent consumer organisations to protect your rights as a consumer D. You trust public authorities to protect your rights as a consumer E. You feel that you are adequately protected by existing measures to protect consumers F. In general, sellers/ providers in [your country] respect your rights as a consumer	1=Strongly agree 2=Agree 3= Disagree 4=Strongly disagree 9=[DK/NA]
ZA5466	2010	Q12. For each of the following statements, please tell me if you agree or disagree with it. In [your country] A. It is easy to resolve disputes with sellers/providers through an arbitration, mediation or conciliation body (malfunctioning goods, late/ non-delivery, etc.) B. It is easy to resolve disputes with sellers/ providers through the courts C. You trust independent consumer organisations to protect your rights as a consumer D. You trust public authorities to protect your rights as a consumer E. You feel that you are adequately protected by existing measures to protect consumers F. In general, sellers/ providers in [your country] respect your rights as a consumer	1=Strongly agree 2=Agree 3= Disagree 4=Strongly disagree 9=[DK/NA]

Table A.2: Attitudes towards laws and institutions

Attitudes towards laws and institutions			
Survey	**Year**	**Question**	**Answer format**
ZA5615	2011	Q14. For each of the following statements, please tell me if you agree or disagree with it. In [your country] 1. it is easy to resolve disputes with sellers/providers through an arbitration, mediation or conciliation body (malfunctioning goods, late non-delivery, etc.) 2. it is easy to resolve disputes with sellers/providers through the courts 3. you trust independent consumer organisations to protect your rights as a consumer 4. you trust public authorities to protect your rights as a consumer 5. you feel that you are adequately protected by existing measures to protect consumers 6. in general, sellers/ providers in [your country] respect your rights as a consumer	1=Totally agree 2=Agree 3= Disagree 4=Totally disagree 5=[DK/NA]
ZA5793	2012	Q1. For each of the following statements, please tell me if you agree or disagree with it. In [your country] 1. you trust independent consumer organisations to protect your rights as a consumer 2. you trust public authorities to protect your rights as a consumer 3. you feel that you are adequately protected by existing measures to protect consumers 4. in general, retailers/providers respect your rights as a consumer 5. it is easy to settle disputes with retailers/providers through an out of court body (i.e. arbitration, mediation or conciliation body) 6. it is easy to settle disputes with retailers providers through the courts	1=Strongly agree 2=Agree 3= Disagree 4=Strongly disagree 9=[DK/NA]
ZA5943	2014	Q3. How strongly do you agree or disagree with each of the following statements. In [your country] 1. You trust public authorities to protect your rights as a consumer 2. In general, retailers and service providers respect your rights as a consumer 3. You trust non-governmental consumer organisations to protect your rights as a consumer 4. It is easy to settle disputes with retailers and service providers through an out-of- court body (i.e. arbitration, mediation or conciliation body) 5. It is easy to settle disputes with retailers and service providers through the courts	1=Strongly agree 2=Agree 3= Disagree 4=Strongly disagree 5=[DK/NA]

Table A.2: Attitudes towards laws and institutions

Age			
Survey	**Year**	**Question**	**Answer format**
ZA5218	2009	D2. How old are you?	[age]=number of years old, 00=Refusal/No answer
ZA5466	2010	D2. How old are you?	[age]=number of years old, 00=Refusal/No answer
ZA5615	2011	D1. How old are you?	[age]=number of years old, 99=Refusal
ZA5793	2012	D1. How old are you?	[age]=number of years old, 99=Refusal
ZA5943	2014	D1. How old are you?	[age]=number of years old, 99=Refusal
Education			
Survey	**Year**	**Question**	**Answer format**
ZA5218	2009	D3. How old were you when you stopped full-time education?	[..]=age when education was terminated, 00=Still in full time education, 01=Never been in full time education, 99=Refusal/No answer
ZA5466	2010	D3. How old were you when you stopped full-time education?	[..]=age when education was terminated, 00=Still in full time education, 01=Never been in full time education, 99=Refusal/No answer
ZA5615	2011	D4. How old were you when you stopped full-time education?	[..]=age when education was terminated, 00=Still in full time education, 01=Never been in full time education, 99=Refusal/No answer
ZA5793	2012	D4. How old were you when you stopped full-time education?	[..]=age when education was terminated, 00=Still in full time education, 01=Never been in full time education, 98=Refusal, 99=DK
ZA5943	2014	D4. How old were you when you stopped full-time education?	[..]=age when education was terminated, 00=Still in full time education, 01=Never been in full time education, 98=Refusal, 99=DK

Table A.3: Demographic and social characteristics

Language skills			
Survey	**Year**	**Question**	**Answer format**
ZA5218	2009	-	-
ZA5466	2010	Q5. Thinking generally about purchasing goods or services from sellers providers located elsewhere in the European Union, which we refer to as "cross-border shopping", please tell me to what extent you agree or disagree with each of the following statements. A. You are prepared to purchase goods and services using another European Union language	1=Totally agree, 2=Agree, 3=Disagree, 4=Totally Disagree, 9=DK/NA
ZA5615	2011	Q5. Thinking generally about purchasing goods or services from sellers providers located elsewhere in the EU, which we refer to as "cross-border shopping", please tell me to what extent you agree or disagree with each of the following statements. 1. You are prepared to purchase goods and services using another EU language	1=Totally agree, 2=Agree, 3=Disagree, 4=Totally Disagree, 5=DK/NA
ZA5793	2012	Q17. Thinking generally about purchasing goods or services from retailers providers located elsewhere in the European Union, either online, through other distance channels (post, telephone) or when travelling abroad, which we refer to as "cross-border shopping", please tell me to what extent you agree or disagree with each of the following statements. 1. You are prepared to purchase goods and services using another EU language	1=Totally agree, 2=Agree, 3=Disagree, 4=Totally Disagree, 5=DK/NA
ZA5943	2014	Q18. Which languages can you use comfortably for personal interests such as shopping, searching the web or other uses ?	1=Bulgarian, 2=Czech, 3=Croatian etc., 30=DK/NA

Table A.3: Demographic and social characteristics

Occupation			
Survey	**Year**	**Question**	**Answer format**
ZA5218	2009	D4. As far as your current occupation is concerned, would you say you are self-employed, an employee, a manual worker or would you say that you are without a professional activity? Does it mean that you are a(n)	Self-employed, i.e. 11=farmer, forester, fisherman, 12=owner of a shop, craftsman, etc., Employee, i.e. 21=professional (employed doctor, lawyer, accountant, architect), etc., Manual worker, 31=supervisor / foreman (team manager, etc...), etc., Without a professional activity, 41=looking after the home, etc., 99=Refusal
ZA5466	2010	D4. As far as your current occupation is concerned, would you say you are selfâĂŘemployed, an employee, a manual worker or would you say that you are without a professional activity? Does it mean that you are a(n)	Self-employed, i.e. 11=farmer, forester, fisherman, 12=owner of a shop, craftsman, etc., Employee, i.e. 21=professional (employed doctor, lawyer, accountant, architect), etc., Manual worker, 31=supervisor / foreman (team manager, etc...), etc., Without a professional activity, 41=looking after the home, etc., 99=Refusal
ZA5615	2011	D5. As far as your current occupation is concerned, would you say you are self-employed, an employee, a manual worker or would you say that you are without a professional activity? Does it mean that you are a(n)	Self-employed, 1=Farmer, forester, fisherman, etc, Employee, 6=Professional (employed doctor, lawyer, accountant, architect...), etc., Without a professional activity, 17=Looking after the home, 22=Refusal
ZA5793	2012 con	D5a. As far as your current occupation is concerned, would you say you are self-employed, an employee, a manual worker or would you say that you are without a professional activity?	1=Self-employed, 2=Employee, 3=Manual worker, 4=Without a professional activity, 5=Refusal
		D5b-e. Would you say you are ?	D5b: 1=Farmer, forester, fisherman etc., D5c: 1=Professional (employed doctor, lawyer, accountant, architect etc. D5d: 1=Supervisor foreman (team manager, etc...), D5e: 1=Looking after the home
ZA5943	2014	D5a. As far as your current occupation is concerned, would you say you are self-employed, an employee, a manual worker or would you say that you are without a professional activity?	1=Self-employed, 2=Employee, 3=Manual worker, 4=Without a professional activity, 5=Refusal
		D5b-e. Would you say you are ?	D5b: 1=Farmer, forester, fisherman etc., D5c: 1=Professional (employed doctor, lawyer, accountant, architect etc. D5d: 1=Supervisor foreman (team manager, etc...), D5e: 1=Looking after the home

Table A.3: Demographic and social characteristics

A.2 Relation of occupation to other demographic characteristics

Occupation	Not reported	15-30	31-45	46-60	61-75	76-100	Total
Not reported	1%	26%	30%	27%	14%	3%	100%
Self-employed	0%	11%	36%	40%	12%	1%	100%
Employees	0%	15%	39%	40%	5%	0%	100%
Manual worker	0%	19%	36%	39%	6%	0%	100%
Not working	0%	18%	9%	18%	42%	13%	100%

Table A.4: Occupation and age

Occupation	Still in education	Never in education	<15 years	16-20 years	20+ years	Refusal / DK	Total
Not reported	6%	0%	15%	37%	39%	3%	100%
Self-employed	1%	0%	6%	32%	39%	23%	100%
Employees	1%	0%	3%	32%	42%	23%	100%
Manual worker	1%	1%	9%	50%	19%	21%	100%
Not working	10%	1%	12%	30%	20%	26%	100%

Table A.5: Occupation and education

Appendix B

Limitation Periods

Country	Source	Length (years)	Additional rules	Starting moment	Suspension
Austria	Section 1489 Civil Code, Section 37a (4) Cartel Act	3	Capped at 30 years from occurrence of damage	From knowledge of damage and infringer	Infringements after 2013: Suspension until six months after proceedings before NCA, Commission or court
Belgium	Section 2262bis Civil Code	5	Capped at 20 years from occurrence of damage	From knowledge of damage and infringer	No
Bulgaria	Section 104 Competition Act (since 2008)	5	N/A	From the moment the final NCA decision became final	Suspension through starting moment
Croatia	Article 376(1) Act on Obligations	3	Capped at 5 years from occurrence of damage	From knowledge of damage and infringer	Suspension for duration of proceedings before NCA or Commission (Article 69a(6) Competition Act)
Czech Republic	Section 397 Commercial Code	4	Capped at 10 years from occurrence of damage, 15 for deliberate torts	From knowledge or when the claimant could have known about the damage and the infringer	No (discretion civil court)
Cyprus	Article IIB Limitation of Actions Law 2012	6	No	From occurrence of damage	No
Denmark	Section 25 Competition Act	3	Capped at 10 years from occurrence of damage	From knowledge or when the claimant could have known about the damage and the infringer	Suspension until 1 year after public decision, only if claimant complained at NCA
Estonia	Subsection 150(1-3), 160(1) Civil Code Act	3	Capped at 10 years from occurrence of damage	From knowledge or when the claimant could have known about the damage and infringer	No

Table B.1: Rules on limitation periods in EU Member States

Country	Source	Length (years)	Additional rules	Starting moment	Suspension
Finland	Section 20 Unfair Competition Act	10	Before 2011: 5 years after the claimant became aware or should have become aware of the damage	From occurrence of damage (if continuous infringement: from ending of violation)	Until one year after the final decision of an NCA decision
France	Article 2224 and 2254 Civil Code (since 2008), Article 423-418 Consumer Code on group actions	5	Party choice 1-10 years	From knowledge or when the claimant should have known necessary facts to exercise right ('manifestation of damage')	Until final decision of NCA, Commission or court (Article L. 462-7 Commercial Code)
Germany	Section 195, 199(1) and 204(2) Civil Code, Section 33(5)(i) Act against Restraints of Competition	3	Capped at 10 years from when the claim arose, or 30 years from occurrence of damage; Party choice 3-20 years	From the end of the year of occurrence of the damage and when the claimant knows, or should have known if not for gross negligence, of the damage and the infringer	Since 2005: Suspension for duration of proceedings at NCA or Commission and 3,5 years after
Greece	Section 937 Civil Code	5	Capped at 20 years from occurrence of damage	From knowledge of damage and infringement	No
Hungary	Section 324(1) Civil Code	5	If claimant is unable to enforce the claim for an excusable reason, e.g. the damage was concealed: one year after knowledge	From occurrence of damage	Public proceedings can form an excusable reason for the claimant to enforce the claim, in which case the time limit is suspended until one year after these finish.
Ireland	Article 11 Statute of Limitations	6	N/A	From occurrence of damage ('cause of action accrued'), starting after a continuous infringement ended	No

Table B.1: Rules on limitation periods in EU Member States

Country	Source	Length (years)	Additional rules	Starting moment	Suspension
Italy	Articles 2935 and 2947 Civil Code	5	No party freedom	From knowledge or when the claimant reasonably should have known of the infringement and the damage	No
Latvia	Civil Law (Article 1895-6)	10	N/A	From knowledge of infringement ('sufficient basis for bringing the act')	No
Lithuania	Article 1.125(8) Civil Code	3	N/A	From occurrence of damage / knowledge (court's discretion)	No
Luxembourg	Article 189 Code of Commerce, Article 2262 Civil Code	10	30 years if claimant is not a commercial company	From knowledge of the harmful act	No
Malta	Article 27A(9) Competition Act (since 2011)	2	N/A	From knowledge or when or when the claimant should have reasonably known of the damage and the infringer	Suspension during proceedings at NCA or Commission
Netherlands	Article 3:310 Civil Code	5	Capped at 20 years from occurrence of damage	From knowledge of damage and infringer	No
Poland	Article 442(1) Âğ 1 Civil Code	3	Capped at 10 years from occurrence of damage	From knowledge of the damage and the infringer (and: starts to run during single and continuous infringement)	No

Table B.1: Rules on limitation periods in EU Member States

Country	Source	Length (years)	Additional rules	Starting moment	Suspension
Portugal	Article 309 and 498 Civil Code	3	Capped at 20 years from occurrence of damage	From knowledge of the right to compensation	No
Romania	Article 61(6) Competition Law, Article 2517 Civil Code	2	N/A	From when the NCA or Commission decision is final (for stand-alone cases: 3 years from knowledge / should have had knowledge)	Included in starting moment of limitation period
Slovakia	Section 398 Commercial Code	4	Capped at 10 years from occurrence of damage	From knowledge of damage and infringer	No
Slovenia	Article 352(1,2) Civil Code	3	Capped at 5 years from occurrence of damage	From knowledge of damage and infringer	Suspension during the procedure before the NCA
Spain	Art. 1968 and 1902 Civil Code, Supreme Court judgement of 8 March 2013, ECLI:ES:TS:2013:836.	1	Interruption by formal notice	From knowledge of damage and infringer (and: starts to run already during single and continuous infringement)	No
Sweden	Article 25 Swedish Competition Act (since 2005)	10	Before 2005: 5 years	From occurrence of damage	No
United Kingdom	Section 2 Limitation Act 1980, Section 31 Competition Appeal Tribunal Rules	6 (High Court), 2 (CAT)	N/A	From accrual of the cause of action (High Court), from moment the NCA or court decision became final (CAT)	CAT: suspension for public proceedings, but not for appeals on penalty only.

Table B.1: Rules on limitation periods in EU Member States

Appendix C

Leniency and Damages

C.1 Explaining Figures 6.3, 6.4 and 6.5

Figures 6.3, 6.4 and 6.5 depict the condition for which firms are indifferent between reporting and not reporting in a special liability system. Figure C.1 below shows how this condition, given by the line $p = \frac{F_R+D_R}{F+D_{NR}}$, is obtained. As can be seen from Figure C.1, the indifference condition runs from $(0, \frac{D_R}{F+D_{NR}})$ to $(F, \frac{F_R+D_R}{F+D_{NR}})$, whereas the indifference condition in a public enforcement system runs from $(0, 0)$ to $(F, 1)$ (see Figure C.2 below). The effect on reporting of including a special liability system, as compared to a public enforcement system, can be explained by two opposite effects.

First, an increase in damages affects the pay-off of reporting more than the pay-offs of not reporting as long as the probability of detection is smaller than one. This makes not reporting relatively more attractive when damages are introduced, as illustrated by rotation #1 in Figure C.1. This effect also occurs when introducing a normal liability system, as can be seen from Figure C.2 below.

Secondly, in a special liability system the immunity recipient pays less damages than a firm that did not report. This makes reporting relatively more attractive,

as shown by rotation #2 in Figure C.1. This effect also occurs when introducing an exemption system, as is shown in Figure C.2 below.

The overall effect on reporting of introducing civil damages by way of a special liability system depends on which of these two effects is stronger. This, in turn, depends on the sizes of F, F_R, D_{NR} and D_R, as specified in Proposition 6.3.

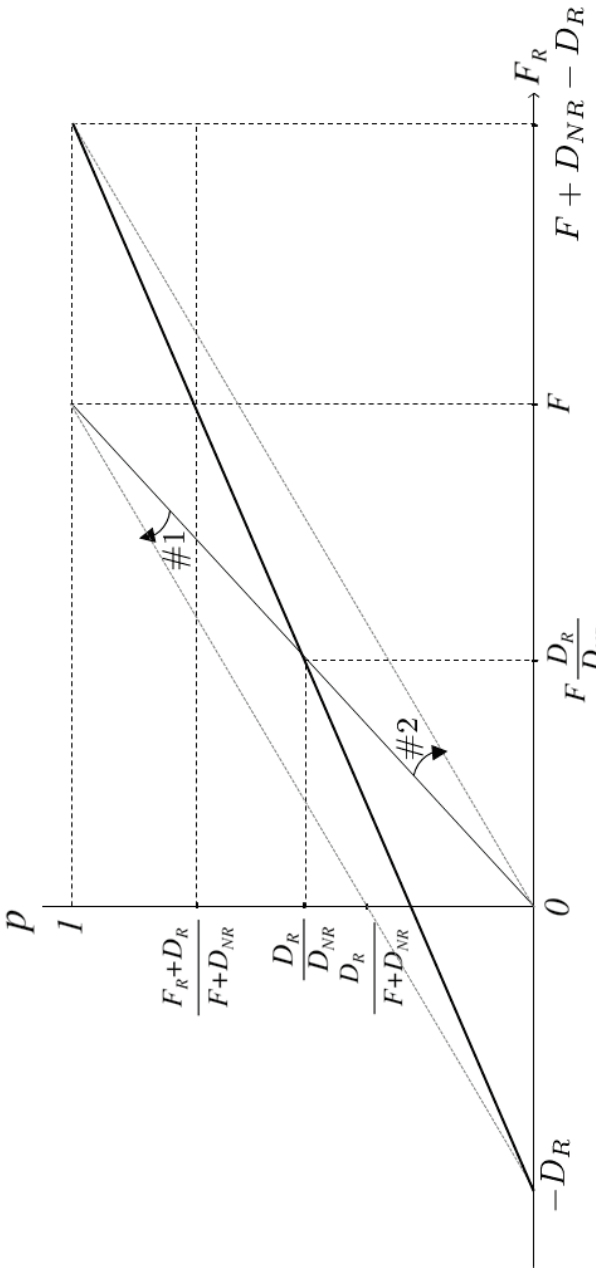

Figure C.1: Explaining the effect of a special liability system on reporting

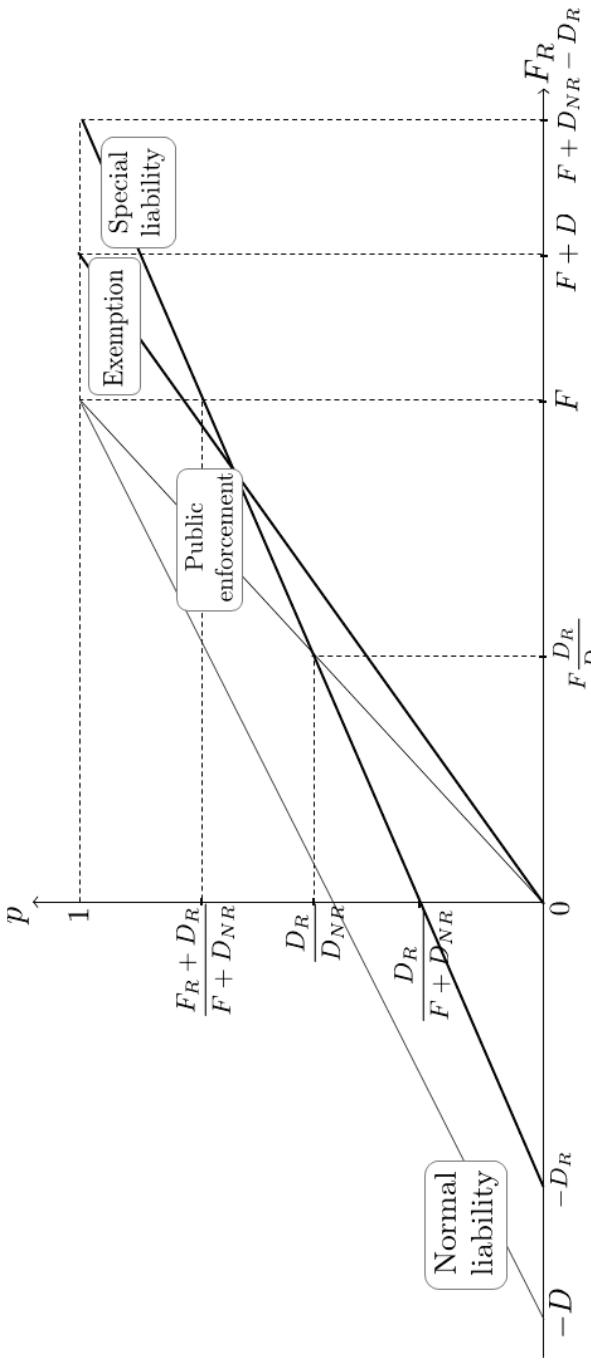

Figure C.2: Comparing the various liability systems

C.2 Proof of Proposition 6.3

Figures 6.3, 6.4 and 6.5 each show two triangles. The striped triangle in each of these figures depicts the combinations of fines, damages and detection probabilities for which firms do report in a special liability system, but not in a public enforcement system - i.e. an improvement in reporting thanks to the special liability system. The dark shaded triangle depicts the opposite, namely a reduction in reporting in a special liability system as compared to a public enforcement system. If the striped triangle is larger than the dark shaded triangle, a special liability system induces more reporting than a public enforcement system.

The area of these triangles, $M1$ and $M2$ in Figure C.3 below, can be calculated with the help of the areas of triangles $H1$ and $H2$.

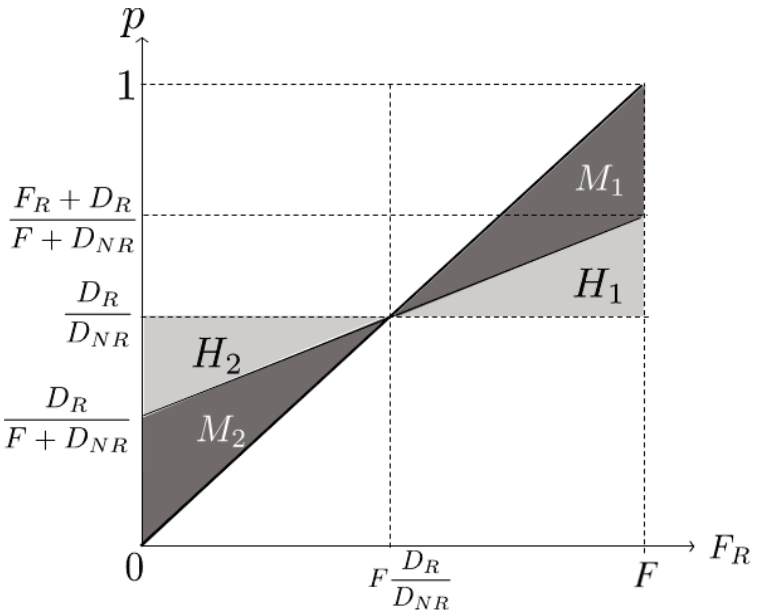

Figure C.3: Calculating when a special liability system induces more reporting than a public enforcement system

The area of triangle $M1$ can be found as follows:

$$A(H1) = \frac{1}{2}\left[\left(F - F\frac{D_R}{D_{NR}}\right)\cdot\left(\frac{F_R + D_R}{F + D_{NR}} - \frac{D_R}{D_{NR}}\right)\right] = \frac{1}{2}\left[F\frac{F_R + D_R}{F + D_{NR}}\left(1 - \frac{D_R}{D_{NR}}\right) + F\frac{D_R}{D_{NR}}\left(\frac{D_R}{D_{NR}} - 1\right)\right]$$

$$A(H1 + M1) = \frac{1}{2}\left[\left(1 - \frac{D_R}{D_{NR}}\right)\cdot\left(F - F\frac{D_R}{D_{NR}}\right)\right] = \frac{1}{2}\left[F + F\frac{D_R}{D_{NR}}\left(\frac{D_R}{D_{NR}} - 2\right)\right]$$

$$A(M1) = A(H1 + M1) - A(H1) = \frac{1}{2}\left[F\left(1 - \frac{F_R + D_R}{F + D_{NR}}\right)\right]$$

The area of triangle $M2$ can be found as follows:

$$A(H2) = \frac{1}{2}\left[\left(\frac{D_R}{D_{NR}} - \frac{D_R}{F + D_{NR}}\right)\cdot\left(F\frac{D_R}{D_{NR}}\right)\right]$$

$$A(H2 + M2) = \frac{1}{2}\left[\frac{D_R}{D_{NR}}\cdot F\frac{D_R}{D_{NR}}\right]$$

$$A(M2) = A(H2 + M2) - A(H2) = \frac{1}{2}\left[F\frac{D_R}{D_{NR}}\left(\frac{D_R}{F + D_{NR}}\right)\right]$$

A special liability system induces more reporting than a public enforcement system if $A(M1) > A(M2)$:

$$\frac{1}{2}\left[F\left(1-\frac{F_R+D_R}{F+D_{NR}}\right)\right] > \frac{1}{2}\left[F\frac{D_R}{D_{NR}}\left(\frac{D_R}{F+D_{NR}}\right)\right]$$

$$1-\frac{F_R+D_R}{F+D_{NR}} > \frac{D_R}{D_{NR}}\cdot\frac{D_R}{F+D_{NR}}$$

$$\frac{F-F_R+D_{NR}-D_R}{D_R} > \frac{D_R}{D_{NR}}$$

Yielding the final condition:

$$F-F_R+D_{NR}-D_R > \frac{D_R^2}{D_{NR}}$$

Summary

During the last years, the European Union has faced the questions of its legitimacy, its role and its future more fiercely than ever since the European project was initiated. One of the key questions is when it is desirable and necessary to introduce new European rules. This thesis offers an answer to this question from a Law and Economics perspective in the area of EU private law, focusing on consumer contract law and antitrust damages actions.

The thesis relies on the framework provided by the economic theory of federalism, which postulates that centralising a policy needs to be justified by a particular benefit, to compensate for the lower correspondence to local preferences and lost possibilities for regulatory experimentation. Against this theoretic background, the thesis advocates that the subsidiarity principle, which governs the exercise of competences by the EU institutions, ought to be an efficiency principle that weighs the various economic arguments in favour and against harmonisation.

The thesis extends the framework of the economics of federalism in several ways. First, the thesis explores the link between the economics of federalism and the economics of integration. It is found that there are hardly any limits to the possibilities to harmonise rules for completing the internal market if one follows the logic of the economic concept of market integration, which also underlies the internal market's legislative competence of the EU. Almost any variation in Member States' legal rules could be considered as an obstacle to the internal market. An overarching economic theory of harmonisation needs to take account not only of reductions in transaction costs and other trade barriers, but also of broader welfare effects. By incorporating heterogeneous preferences into a trade model, the thesis illustrates that harmonising rules involves a trade-off between enhancing competition by reducing transaction costs, and ensuring that policies correspond to citizens' preferences.

Further extensions of the economics of federalism framework are identified in the scope and enforcement of EU legislation. The limited scope of the Antitrust Damages Directive in terms of its rules on limitation periods may limit the extent to which the Directive can achieve its goal of providing a 'level playing field' for antitrust damages claims throughout the EU. The second goal of this Directive, to balance public and private antitrust enforcement, may require an adjustment to some of the substantive rules on liability, in order to prevent that damages claims undermine the success of the leniency program.

Building upon the insights from the economics of federalism, the thesis aims to show that the effects of harmonisation lie not only in a reduction of transaction costs, but also in the substantial rules included in the EU policy, their scope of application, and their enforcement. The implication for policy making is that the justification for further harmonisation should go beyond the limited focus on the beneficial effects on the internal market, to include a wider range of welfare considerations.

Samenvatting

De afgelopen jaren staan de legitimiteit, rol en toekomst van de Europese Unie meer ter discussie dan ooit tevoren sinds haar oprichting. Een van de hoofdvragen is wanneer het zinvol en noodzakelijk is om nieuwe Europese regels te introduceren. Deze dissertatie biedt een antwoord op deze vraag vanuit een rechtseconomisch perspectief op het gebied van Europees privaatrecht, gericht op consumenten contractrecht en schadevorderingen voor inbreuken op het mededingingsrecht.

De dissertatie baseert zich op het raamwerk van de economische theorie van het federalisme. Deze theorie stelt dat het centraliseren van beleid dient te worden gerechtvaardigd door een bepaald voordeel, om ervoor te compenseren dat lokale voorkeuren minder goed zijn vertegenwoordigd in het beleid, en mogelijkheden voor beleidsleereffecten worden weggenomen. Tegen deze theoretische achtergrond bepleit de dissertatie dat het subsidiariteitsprincipe, dat de uitvoering van EU bevoegdheden begrenst, een efficiëntieprincipe behoort te zijn dat de economische argumenten voor en tegen harmonisatie tegen elkaar afweegt.

De dissertatie breidt het raamwerk van de economische theorie van het federalisme in meerdere opzichten uit. Ten eerste onderzoekt de dissertatie de relatie tussen economisch federalisme en de economische theorie van integratie. Er blijken nauwelijks grenzen te zijn aan de mogelijkheden voor harmonisatie om de interne markt te verbeteren wanneer de logica van economische marktintegratie wordt gevolgd, de logica die ook aan de interne marktbevoegdheid van de EU ten grondslag ligt. Vrijwel elke variatie in regelgeving kan worden beschouwd als een barrière voor de interne markt. Een overkoepelende economische theorie van harmonisatie dient niet alleen het terugdringen van transactiekosten en andere handelsbarrières in acht te nemen, maar ook algemene welvaartseffecten. Door heterogene voorkeuren van consumenten op te nemen in een handelsmodel laat de dissertatie zien dat het harmoniseren van regelgeving een afweging betekent tussen het versterken van marktconcurrentie door transactiekosten te verminderen, en de mate waarin het beleid aansluit bij de preferenties van burgers.

Verdere uitbreidingen van het raamwerk van economisch federalisme betreffen de reikwijdte en handhaving van EU maatregelen. De beperkte reikwijdte van de Richtlijn privaatrechtelijke handhaving mededingingsrecht in het opzicht van de regels voor verjaringstermijnen zou kunnen beperken in hoeverre de Richtlijn haar doelstelling zal bereiken om een 'gelijk speelveld' te creëren in de EU voor schadevergoedingen voor inbreuken van het mededingingsrecht. De tweede doelstelling

van de Richtlijn, het uitbalanceren van publieke en private handhaving van het mededingingsrecht, vergt mogelijk een aanpassing in de materiële aansprakelijkheidsregels, om te voorkomen dat schadeclaims het functioneren van het clementieprogramma ondermijnen.

Voortbouwend op de inzichten van het economisch federalisme beoogt de dissertatie aan te tonen dat de effecten van harmonisatie niet slechts liggen in het terugdringen van transactiekosten, maar ook in de inhoud van het EU beleid, alsmede de reikwijdte en handhaving ervan. De implicatie voor beleidsvorming is dat verdere harmonisatie behoort te worden onderbouwd met meer dan de beperkte blik van transactiekostenbesparingen, en bredere welvaartsoverwegingen dient te betrekken.

Curriculum vitae

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Short bio

Miriam Buiten is a PhD researcher focusing on the economics of European integration. She has a background in both economics and law. In her thesis she applies economics of federalism, trade models and game theory in order to study the optimal level of European harmonization aimed at improving the internal market, focusing on consumer protection and private antitrust enforcement. She compares the economic considerations for harmonisation with the legal framework laid down in internal market law and European constitutional law. Her research interests also include enforcement of law, collective redress mechanisms, competition policy and intellectual property law.

Education	
Master International and European Public Law (LL.M. cum laude)	9/2013-8/2015
European Master in Law & Economics (M.Sc. with distinction)	10/2011-8/2012
Bachelor of Laws in Dutch Law (LL.B.)	9/2007-8/2011
Bachelor of Science in Economics (B.Sc.)	9/2007-7/2011
Work experience	
Bluebook Trainee at the European Commission	10/2016-2/2017
Lecturer at the Erasmus University	3/2013-9/2016
Staff jurist at Stibbe	6/2014-11/2015
Teaching Assistant and Student Assistant at the Erasmus University	9/2010-9/2012
Legal intern at Loyens & Loeff	8/2011-9/2011
Volunteer legal advisor at *Recht op je Recht*	10/2010-8/2011
Publications	
M. Senftleben, M. Kerk, M.C. Buiten and K. Heine, "From Books to Content Platforms – New Business Models in the Dutch Publishing Sector" International Review of Intellectual Property and Competition Law (*forthcoming*)	2017
M. Senftleben, M. Kerk, M.C. Buiten and K. Heine, "Nieuw rechten voor nieuwe businessmodellen in de uitgeefsector?", Tijdschrift voor Auteurs-, media- en informatierecht, forthcoming.	2017
M.C. Buiten, “Piecemeal Harmonization of Civil Procedure in the EU: The case of Limitation Periods in the Antitrust Damages Directive”, Hungarian Yearbook of International and European Law 2016.	2016
J. Kantorowicz, T. Hlobil and M.C. Buiten, “E-Commerce: An Analysis of the	2016

Market Structure, Cross-Border Sales, and the Role of Platforms and Intermediaries", study prepared for the European Commission, DG GROW, September 2016.	
J.S. Kortmann and M.C. Buiten, "Private Enforcement and Collective Redress in European Competition Law: The Netherlands", *Private Enforcement And Collective Redress In European Competition Law*, FIDE XXVII Congress Budapest 2016 – Congress Publications.	2016
M.C. Buiten and W. Timmer, "Mechanisms to monitor and manage regulatory burdens" (Dutch title "Mechanismen voor het monitoren en beheersen van regeldruk"), policy report prepared for the Dutch Ministry of Economic Affairs, November 2015.	2015
Others	
M.C. Buiten, P.W. van Wijck and J.K. Winters "Do private damages actions drive out leniency applications?", Working Paper, October 2016.	2016
M.C. Buiten, "How to coordinate on the passing-on defence?", Working Paper, December 2016	2016

EDLE PhD Portfolio

Name PhD student : Miriam Buiten
PhD-period : 10/2012 – 2/2017
Promoters : Prof. Neil Rickman and Prof. Roger Van den Bergh

PhD training

Bologna courses	***year***
Introduction to the Italian legal system, 10 hours, 2 ECTS. Prof. De Pra.	2012
Game theory and the law, 30 hours, 4 ECTS. Prof. Franzoni.	2012
Economic Analysis of Law, 30 hours, 4 ECTS. Prof. Parisi	2012
Behavioral L&E I - Game Theory, 12 hours, 2 ECTS. Prof. Carbonara	2012
Behavioral L&E II - Enforcement Mechanisms, 12 hours, 2 ECTS. Prof. Vanin	2013
European competition law and intellectual property rights, 12 hours, 2 ECTS. Prof. Tarantino and Prof. Denicolò	2013
European securities and company law, 12 hours, 2 ECTS. Prof. Pomelli.	2013
Experimental L&E - Topics, 20 hours, 4 ECTS. Prof .Casari and Prof. Pancotto	2013
Experimental Economics. Prof. Bigoni and Prof. Bortolotti	2013
Specific courses	***year***
Seminar 'How to write a PhD'	2012
Academic Writing Skills for PhD students (Rotterdam)	2013
Seminar Series 'Empirical Legal Studies'	2014
Hamburg Summer School, courses on The Law and Economics of International Contracts, Prof. Rühl Regulatory Autonomy to pursue Societal Concerns: The Limits under WTO Law, Prof. Prévost Econometrics, Prof. Eisenberg Introduction to German Law, Prof. Rösler	2013
ATLAS Agora Summer School in Montreal, lectures on e.g. *Power, Knowledge and Comparative Legal Traditions,* Prof. Pascale Fournier *Law & Economics – A Toolkit for Research on Law,* Prof. Ejan Mackaay *Culture, Languages and Comparative Law,* Prof. Catherine Piché	2015

Introduction to Canadian Dual Legal Culture, Prof. Michel Morin *Law and Finance,* Prof. Stéphane Rousseau *Law in the Age of Technology,* Prof. Nicolas Vermey	
Seminars and workshops	***year***
BACT seminar series (attendance)	2013-2016
EGSL lunch seminars (attendance)	2013-2015
Joint Seminar 'The Future of Law and Economics' (attendance)	2014
Rotterdam Fall seminar series (peer feedback)	2013
Rotterdam Winter seminar series (peer feedback)	2014
Presentations	***year***
Bologna March seminar Presentation of research proposal.	2013
Hamburg June seminar University of Hamburg, 1 July 2013. Presentation of the paper "To Harmonize Or Not To Harmonize: The Problem of Fragmented Enforcement For European Consumer Protection"	2013
Rotterdam Fall seminar series Erasmus School of Law, Rotterdam, November 14, 2013. Presentation of the paper "To Harmonize Or Not To Harmonize: The Problem of Fragmented Enforcement For European Consumer Protection"	2013
Rotterdam Winter seminar series Erasmus School of Law, Rotterdam, 20 February 2014. Presentation of the paper "EU Initiatives To Boost Cross-Border Shopping: A Transaction Cost Story?"	2014
Bologna November seminar University of Bologna, 7 November 2014. Presentation of the paper "Sector-Specific Harmonization of Civil Procedure in the EU: The case of Limitation Periods in the Antitrust Damages Directive"	2014
Joint Seminar 'The Future of Law and Economics' Université Paris (X) Ouest Nanterre La Défense, 26 March 2015. Presentation of the paper ""Leniency and Damages: How to Treat the Whistleblower?"	2015
Erasmus Law School Poster Presentations Erasmus University Rotterdam, 16 January 2014. Presentation of PhD research.	2014
PhD lunch lecture Erasmus School of Law, Rotterdam, 11 December 2013. Presentation of the paper "To Harmonize Or Not To Harmonize: The Problem of Fragmented Enforcement For European Consumer Protection"	2013
Attendance (international) conferences	***year***
XXVII Congress of the International Federation for European Law (FIDE) Pázmány Péter Catholic University and Kempinski Hotel Corvinus, Budapest, 18 May 2016. Presentation of the paper "Coordinating on the passing-on defense: How not to copy American mistakes?"	2016
Annual Meeting of the European Association of Law and Economics	2015

University of Vienna, 18 September 2015. Presentation of the paper ""Leniency and Damages: How to Treat the Whistleblower?"	
Annual Conference of the Mannheim Competition and Innovation Center Zentrum für Europäische Wirtschaftsforschung GmbH (ZEW) Mannheim, 13 March 2015. Presentation of the paper "Leniency and Damages: How to Treat the Whistleblower?"	2015
German Law and Economics Annual Conference University of Ghent, 11 July 2014. Presentation of the paper "EU Initiatives To Boost Cross-Border Shopping: A Transaction Cost Story?"	2014
Italian Law and Economics Association Annual Conference University of Lugano, December 12, 2013. Presentation of the paper "To Harmonize Or Not To Harmonize: The Problem of Fragmented Enforcement For European Consumer Protection"	2013
German Law and Economics Association Annual Conference University of Bolzano, 13 September 2013. Presentation of the paper "To Harmonize Or Not To Harmonize: The Problem of Fragmented Enforcement For European Consumer Protection"	2013
EMLE Midterm Meeting, Summer School University of Hamburg, 14 February 2013. Presentation of the paper "The Role of Enforcement Mechanisms for Corporate Governance in India"	**2013**
Teaching	***year***
Law and Economics in the Courts, LLM/MSc course Erasmus School of Law, February 2016. I gave a lecture on access to documents in cartel damages actions and graded students' papers on this topic. In a moot court setting, students were asked to bring forward economic arguments in favor or against broad disclosure rules.	2016
Comparative Law and Economics from a European Perspective Erasmus School of Law, March 2013. I gave a lecture to visiting students from Chicago Law School on consumer protection in Europe and the United States.	2013
Advanced Topics of Competition Law and Economic Regulation, LLM/MSc course Erasmus School of Law, April - May 2015. I gave lectures on competition law, focusing on private enforcement and the tensions with public enforcement (6 hours).	2015
Law and Economics ("Rechtseconomie"), LLB course Erasmus School of Law, April 2014. I gave a number of tutorials to two groups of +- 25 students.	2014
Others	***year***

Harmonisation and the EU Internal Market: A Law and Economics Approach

During the last years, the European Union has faced the questions of its legitimacy, its role and its future more fiercely than ever since its foundation. At the same time, an increasingly wide range of policy areas is being harmonised in the realm of the internal market, including parts of private law. This PhD thesis critically examines this harmonisation approach, focusing on consumer protection and antitrust damages actions. The thesis uses a Law and Economics framework, aiming to identify the relevant considerations for determining when harmonisation for the internal market is welfare-improving. In doing so, the thesis aims to contribute to the literature on European integration, and to provide insights for EU policy making.