

The Concept of an ‘Internal Market’

Finance and Constitution Committee

Briefing Paper

Professor Kenneth Armstrong, University of Cambridge

3 August 2020

The Concept of an “Internal Market”

An “internal market” is an economic space consciously created to facilitate economic activity between the territorial jurisdictions that comprise the internal market. It entails governance arrangements that aim to integrate distinct territorial markets – market integration – while allocating and policing decision-making in the public interest between different jurisdictions – market regulation.

While international trade agreements also pursue the goal of increasing market access for goods (and services to a more limited extent), they impose a limited legal discipline based on the non-discrimination principle and respect for the regulatory autonomy of the parties. An internal market is more extensive in its coverage of goods, services and people, and imposes a tighter legal discipline on the ability to apply local rules to cross-border economic activities.

The experience of the European Union in consciously defining and building an internal market is a useful point of reference. If nothing else, it is a helpful reminder that an internal market that comprises different territorial jurisdictions is a legal construction and a political choice. The design of the governance architecture reflects political choices about the scope and reach of the market; about the social and economic values that are to be protected or pursued; and the constitutional relationship between different levels of political authority.

From the experience of the EU internal market we can learn four general lessons:

- An internal market is not an uncontested concept
- Trade-offs and balances are involved in making an internal market
- The operation of an internal market depends upon its governance architecture and its relationship with constitutional settlements.
- There is more than one way to design an internal market.

The UK Government is now proposing to legislate for a UK internal market. Its scope extends to goods, services and professional qualifications. A market access commitment will be enshrined in law and give effect to the principles of non-discrimination and “mutual recognition”. Independent monitoring will consider the functioning of this internal market. Whatever body is established for these purposes, outputs will be in the form of advice and non-binding recommendations. The “internal” market will also need to deal with the implications of “external” trade as the UK Government pursues an independent trade policy outside of EU membership.

Market Access and Regulatory Diversity – From International Trade to an Internal Market

International trade agreements have the aim of increasing market access – primarily for goods – while preserving the autonomy of the parties to regulate economic activity within their respective borders. An internal market entails a more demanding legal discipline on the constituent jurisdictions and is more encompassing in scope in facilitating the market access of goods, services and professionals in regulated sectors.

Trade rules apply a basic **non-discrimination rule** – so goods and services cannot be excluded from a market simply because they originate outside of the jurisdiction – but, nonetheless demands full compliance with local rules before goods and services can be offered on the local market (“**national treatment**”). The effects is that goods and services have market access but only by complying with the local rules of each jurisdiction.

To facilitate the market access of goods, another approach is to make it easier to certificate compliance with local rules by allowing testing and certification to take place outside of the local jurisdiction and closer to where the good originates. It is important to keep in mind that while certification occurs outside of the local jurisdiction, what is certified is that a good meets the regulatory requirements of the local jurisdiction. In EU trade terms, **Mutual Recognition Agreements** (MRAs), facilitate market access through this process.

A different way of reducing the regulatory burden of compliance with multiple local rules is to enhance **regulatory cooperation** between different jurisdictions. This can include enhanced transparency as draft rules are being promulgated. Without formal harmonisation, notification of draft rules for comment, and voluntary adaptation of draft rules can reduce regulatory friction.

The move from an international trade paradigm to that of an internal market sees an intensified control of the capacity of a jurisdiction to impose its local rules to regulate economic activity generated by producers and suppliers located outside of the jurisdiction.

In a multi-jurisdictional internal market with a “federal” or “central” legislative competence, regulatory diversity may be managed by:

- Imposition of common rules applicable in all jurisdictions (“Harmonisation”) and
- Facilitating convergence of rules through intergovernmental coordination.

In the absence of common rules, the competence to regulate the internal market remains with the constituent jurisdictions, but subject to obligations to secure market access. Strategies are needed to reconcile market access with diversity in market regulation.

One strategy is to look for **comparability** between local rules and those which a good or service has complied with in another jurisdiction within the internal market:

- At a sectoral level, formal **equivalence decisions** may be adopted to certify that services originating in one jurisdiction are equivalent to regulatory standards that are required in another jurisdiction (e.g. in financial services).
- At the level of professional qualifications, certificates, diplomas and degrees awarded by one jurisdiction may be accepted as equivalent to those awarded by bodies within the local jurisdiction: **mutual recognition**. Either there is an agreement to recognise

particular qualification as equivalent or there is a procedural duty on local regulators to determine case by case which qualifications are comparable.

- Mutual recognition may also be applied to goods by demanding that jurisdictions give market access to products within the internal market which comply with comparable regulatory standards on health and safety, consumer and environmental protection.

An even more demanding strategy is to subject local regulation to **judicial control**. The intensity of control can vary. It may focus on determining whether the non-discrimination obligation has been breached. At a minimum this would control **direct discrimination** according to the origin of the good or service. But it may extend to control of **indirect discrimination**, focusing on whether an apparently neutral rule has a differential impact on goods and services originating outside of the local jurisdiction. In the EU context, judicial scrutiny may extend yet further to a more wide-ranging analysis of whether local rules prevent, impede or render less favourable market access.

In EU law, the focus of judicial scrutiny lies in determining whether a local restriction on market access is justified having regard to its regulatory purpose. This involves a **proportionality-based interest-balancing assessment** – having regard to its public interest function, is the rule a disproportionate restriction on the market access of the good or service?

Although comparability assessments and judicial control of local rules may start from a presumption that goods and services already lawfully placed on the market should not be denied market access to another jurisdiction within the internal market, the competence of the local jurisdiction to regulate is not in issue; what is controlled is its exercise.

A more far-reaching approach is to confer exclusive regulatory competence for cross-border trade on the state of origin of the good or service.

A model of **home country control** would require that goods and services are accepted on the market simply by virtue of compliance with the rules of the jurisdiction in which the good is produced or in which the service provider is based and regulated. The local jurisdiction is denied the competence to regulate the cross-border market access of goods and services. It can, however, continue to require local producers and suppliers to meet local rules.

Cross-border provision of goods and services means that those economic activities are regulated in the local jurisdiction according to the rules of the home states: an **extraterritorial effect**. **Regulatory competition** may also result. While local jurisdictions remain competent to regulate local producers and suppliers, the presence of goods and services on the local market that comply with different standards may generate pressures on local regulators to adapt local rules or risk the relocation of capital and people to other jurisdictions within the internal market. Asymmetries in regulatory power may also exist.

As we move from a model of international trade based on regulatory autonomy and national treatment to a model of an internal market, the constraints on local regulation intensify. Choices need to be made about what sort of regulatory diversity is permissible and what degree of control is exerted. Internal markets will deploy different control techniques as a matter of political choice and legal design.

The EU Internal Market

The Single European Act (1986) introduced the legal concept of the EU “internal market”:

The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties.

Underlying some of the critique of the new concept was an anxiety that the project of completing the internal market politicised market integration. Throughout the 1960s and 70s, EU and national courts had used the primary law of the treaties to tackle both tariff and non-tariff barriers to trade. Especially for EU lawyers, the treaties formed an “economic constitution” that balanced the objectives of market integration and market regulation without the need for extensive EU-level legislative harmonisation. In other words, judicial control was a dominant strategy of market integration across both goods and services.

The fundamental change heralded by the Single European Act, was not the definition of the internal market, but the legislative competence conferred by Article 100a EEC – now Article 114 TFEU – allowing the EU legislator to adopt common rules to improve the functioning of the internal market. Although there had been a legislative power to support the Common Market since the inception of the Communities, this new power was intended to be a step change in the role of EU legislative institutions in EU-wide rule-making. It signalled a desire to design the internal market within common legal frameworks.

Harmonised rules adopted via Article 114 TFEU are binding throughout the EU but vary from one area to another in terms of the extent to which they establish common rules. Directives establish common outcomes but give scope to the Member States to adjust their national rules to achieve the binding common objectives. Regulations, however, displace national rules and form a common legal framework in their own right.

EU legislation adopted under Article 114 TFEU may be agreed by **Qualified Majority Voting (QMV)** which is a departure from the unanimity rule that applied prior to the Single European Act. This altered the political equilibrium in a significant way. Member States may be more willing to accept the binding constraint of EU law on their regulatory autonomy provided they can exercise collective control over EU rule-making under the shadow of a veto. Introducing QMV meant that a state could be bound by a rule it did not vote for. The more that rules are made by a majority vote, the more likely may be non-compliance and states that have been outvoted also have an incentive to litigate to challenge the constitutionality and legality of the rules.

Example – Rules on Tobacco Advertising

In 1998, the EU enacted rules using its internal market powers to prohibit the advertising of tobacco products in certain locations and through certain media. Germany did not support the measure which it felt was better regulated at national level. It brought legal proceedings to challenge the use of an internal market power to achieve public health objectives. The Court of Justice agreed that in certain respects the measure over-reached what was legally permissible. In doing so it defined the purpose of enacting harmonised EU rules using the internal market power namely that **it must genuinely improve the functioning of the internal market by removing obstacles to trade and distortions to competition.**

Creating a “federal” or “Union” competence to enact common rules for an internal market may be more effective than either managing episodic trade disputes in courts or maintaining the level of mutual trust needed for non-legislative frameworks for cooperation. But it also risks overreach and may itself become the subject of federal disputes over the allocation of decision-making between EU and national levels. This may then entail courts performing a different constitutional role – policing the vertical division of powers.

As well as being a focal point for disputes over the “vertical” division of powers, EU rule-making may controversially alter the “horizontal” division of powers between Member States. The proposal to enshrine the principle of home country control in the original draft of the **Services Directive** was criticised for limiting the regulatory autonomy of jurisdictions to regulate the provision of services on the “host” market.

It is important, however, to recognise that the EU internal market is more than a system for harmonised rule-making. In the absence of common rules, there are significant constraints on the regulatory autonomy of the Member States:

- Draft “technical regulations” require notification to the European Commission (e.g. the Scottish minimum unit alcohol pricing proposal was notified and subject to scrutiny by the European Commission);
- Market authorisations in chemicals and medicines granted by national regulators are subject to mutual recognition obligations to allow cross-border market access;
- Outside of professions where mutual recognition of specific listed qualifications is mandated by EU legislation, there is a general requirement to recognise certificates, diplomas and qualifications granted by other jurisdictions within the internal market;

As noted previously, there is direct control over regulatory autonomy through judicial enforcement of EU economic law. National and EU courts enforce a very wide definition of the non-discrimination principle supplemented by an even wider concern with whether national regulatory requirements prevent or impede market access. Through a proportionality-based balance of economic freedoms and public interest objectives (health, safety, consumer and environmental protection), courts adjudicate claims brought directly by businesses and citizens regarding limits on their market access. This technique is not uncontroversial as it entrusts courts with the task of balancing the economic interests of corporate entities and individuals with the public interest aims of national regulation. With the rise of the regulatory state over the last century and with new risks emerging in services sectors including financial and digital services, the task of balancing economic and social values becomes more extensive.

There is also an important institutional dimension to this controversy. Making courts a focal point for interest-balancing creates opportunities and risks. On the one hand, the adjudication process opens up local decision-making to the rights and interests of those not represented in the local democratic process but who are affected by it. On the other hand, empowering judges to calibrate the balance between economic and social values may feel undemocratic.

The capacity for the EU internal market to intrude into or even conflict with national social policies has been a particular zone of controversy. The right to receive healthcare services in another Member State as an internal market right was used by UK NHS patients to obtain hip replacements abroad with the NHS then expected to reimburse the costs. The “posting of workers” from one state to another has brought local rules on collectively-bargained wages

into conflict with cross-border service providers seeking to pay “home state” wages to the workers that they post. Court judgments have brought the Court of Justice into controversy. Some would prefer certain sectors to be excluded from the scope of the internal market while authors prefer a better balance of economic and social interests.

Striking a balance between common “Union” rule-making and the judicial control of decentralised “national” regulation also serves another function. A judicially policed internal market may create the conditions for regulatory competition. While some of that competition may drive innovation in regulatory policy it also risks undermining local democratic choices. The adoption of common rules and standards can either eliminate damaging regulatory competition or limit it by creating a floor level of common rules. However, in turn, that raises the question of the democratic quality of common rules.

The EU internal market also needs to be understood in the context of the EU’s **external trade** policy. EU courts have been very reluctant to permit EU trade agreements to be enforced in courts to undermine EU or Member States’ regulatory powers. At the same time, implementation of EU trade agreements may entail the adoption of common EU regulations to be applied uniformly across EU states. As the example of local authorisation of genetically modified organisms demonstrates, trade disputes may arise because of diversity in local regulatory preferences within the internal market.

As the UK leaves the EU internal market, the protection of regulatory policy is an apparent priority for the UK Government. Negotiating a free trade agreement with the EU is intended to protect and maximise UK regulatory autonomy not least with a view to calibrating internal regulatory policy against external free trade ambitions.

But in designing a UK internal market, consideration needs to be given to the types of controversy highlighted by the experience of the EU internal market and their implications within the constitutional settlement of the UK and the division of powers between UK and devolved governments as well as between legislatures and non-majoritarian institutions like courts and other supervisory bodies.

The sorts of trade-offs and balances we see in the EU internal market include:

- *Uniformity versus diversity*: should the balance be in favour of local regulatory diversity or common normative frameworks?
- *Exclusive or shared powers*: should regulatory power be definitively allocated to one jurisdiction or shared but subject to supervisory mechanisms?
- *Internal versus external*: should the internal market drive external trade policy or the other way round?
- *Political versus independent accountability*: should preference be given to independent agencies and courts to manage risks and strike balances or should this be entrusted to politically accountable institutions at central and local levels?
- *Democratic inclusion and exclusion*: should regulation respond only to local democratically expressed preferences or should it have to recognise external affected interests?
- *Market and non-market values*: should priority always be given to market access or should non-market public interest values have to be recognised and reconciled?
- *Certainty or flexibility*: should the design of an internal market prioritise certainty of outcomes or be more flexible to allow for different circumstances to be considered?

A UK Internal Market in the Context of Brexit

Consequent to its withdrawal from the EU, once the transition period ends on 31 December 2020, the UK will leave the EU internal market. At that moment, existing EU law will become domestic “retained EU law”. In principle, UK rules could then diverge from those of the EU. But absent the common external framework of EU law, the exercise of their respective competences could also see the UK and the devolved nations diverge internally from the body of “retained EU law” in their regulation of economic activity.

The European Union (Withdrawal) Act 2018 empowers UK ministers to place limitations on the exercise of the legislative and executive competences of devolved institutions to modify retained EU law. Under section 12 of the Act, the prohibition on devolved legislatures from legislating contrary to EU law contained in the Scotland Act 1998 is changed into a prohibition on modifying retained EU law to the extent that UK ministers limit that modification by regulations adopted within two years under the Act. Schedule 3 of the Act extends this prohibition to any subordinate legislation made by Scottish Ministers.

This “freezing” power conferred on UK ministers is a “backstop”. The Act envisages that other “arrangements” will displace restrictions on the power to modify retained EU law. An “arrangement” may or may not be legally enforceable. Thus, the potential for UK ministers to restrict any modification of retained EU law – including for the purpose of maintaining a UK internal market – is intended to encourage intergovernmental cooperation between UK and devolved administrations. Thus far, the section 12 power has not been used.

The ambition of “arrangements” in the form of “common frameworks” is that the concept of an internal market can be internalised in the fields within the scope of the frameworks. The Revised Framework Analysis anticipates that **seventy-eight policy areas** where EU rules exist could be managed by non-legislative frameworks (supplemented with secondary legislation). Nonetheless, the Revised Frameworks Analysis recognises **twenty-one areas** where legislation may be needed. This includes areas such as chemicals, pesticides, professional qualifications, fisheries, food safety and labelling, animal feed and cultivation of genetically modified crops. It is in these important areas that the respective powers of Union and devolved institutions to modify retained EU law (or indeed to enact entirely novel rules where no EU rules previously existed) falls to be assessed.

The five-phased approach to intergovernmental agreement on common frameworks is challenging not least in terms of delivering agreed outcomes before the end of the transition period on 31 December 2020. As sectoral replacements to the EU internal market, this approach does not have the encompassing and “constitutionalised” legal guarantees of market access that we associate with EU law. However, it may better reflect both the reality of the diversity and distinctiveness of governance in particular policy areas (even during EU membership) as well how that pattern maps onto the division of competences within the UK.

The structures for the governance of “internal” economic activity also need to take into account UK “external” trade policy after the expiry of the transition period. It should be recalled that sections 35 and 58 of the Scotland Act 1998 gives UK ministers intervention powers to ensure that devolved institutions do not act incompatibly with UK international obligations. These powers become more relevant as the UK develops its independent trade policy post-Brexit.

The White Paper

The UK Government is proposing a **Market Access Commitment** to be enshrined in law by the end of 2020 and comprising two legal principles:

- A “**mutual recognition**” principle. and
- A **non-discrimination** principle.

The legislation will be applicable to:

- Goods
- Services
- Professional Qualifications.

In respect of distortions to competition from subsidies, the UK Government intends to make the control of subsidies a reserved competence.

Scope

Within its scope, the legislation will apply the market access commitment not just to primary law but also secondary legislation and other regulatory norms that condition the offer of a good, service or a profession on the UK internal market. Within its scope, the mutual recognition principle may be excluded in favour of the non-discrimination principle (see below). Certain areas are out of the scope of the legislation: reserved matters; taxation and spending matters covered by fiscal frameworks; matters with limited market access impacts (including certain social policy measures); pre-existing differences. The precise delineation of scope will be settled in advance with the expectation that these will not change. The proposed legislation is also subject to the operation of the Protocol on Ireland/Northern Ireland and the continued alignment of rules in that jurisdiction with EU law to the extent required to comply with the Protocol.

Goods

The White Paper states that mutual recognition is the “default presumption” for goods. However, it is not apparent what would rebut the presumption. Indeed, the “mutual recognition” principle appears more like a home country control principle in that it would allocate regulatory competence in cross-border trade to the jurisdiction where a good originates with the good having unrestricted access to the markets of the other jurisdictions.

The White Paper suggests limiting the “mutual recognition” approach to areas relating to the lawful sale of goods. Although undefined this might include rules relating to product composition, packaging and labelling. It could extend to rules that regulate the sale of a good according to its manner of production (e.g. adherence to labour or environmental standards). As regards other rules including those that relate to the “manner of sale” of goods – e.g. times and place when goods might be sold; advertising, promotional activities and marketing strategies – the White Paper suggests that the non-discrimination principle would apply.

The non-discrimination principle prohibits obstacles to market access deriving from direct discrimination based on the origin of a good in another constituent jurisdiction of the UK. The White Paper implies that – but solicits views on whether – this should extend to rules that are indirectly discriminatory. *It is unclear whether this principle entails the balancing of economic freedom with the public interest in local regulation and if so, which public interests are recognised as legitimate interferences with market access.*

With different legal principles in operation, the demarcation of the dividing line between the application of the “mutual recognition” and “non-discrimination” principles will be both crucial but also difficult.

Services

The White Paper anticipates retaining the approach of the 2009 Provision of Services Regulations combined with the non-discrimination principle. The 2009 Regulations transposed the EU Services Directive into UK law. The original proposal for the Directive gave prominence to the home country control principle. The adopted Directive instead placed controls on the “host state”, particularly in respect of “authorisation schemes” which a jurisdiction sought to apply to the provision of a service. These controls emphasise the non-discrimination principle and the need to balance in a proportionate manner the public interest objective of the jurisdiction seeking to apply an authorisation procedure with the economic interests of service providers. Crucially, applying the mutual recognition principle, any controls must not duplicate controls already applied to the service in another jurisdiction and “that are equivalent or essentially comparable as regards their purpose”.

Professional Qualifications

For professional qualifications, some areas will be subject to the normal application of the mutual recognition principle based on the comparability of the qualifications, while in other areas, any obstacles arising from differences in the regulation of professions is subject to the non-discrimination principle.

Governance and Enforcement

The UK Government proposes:

- Independent monitoring and reporting on the functioning of the internal market, and
- Business and consumer engagement.

Whatever body is established for these purposes, outputs will be in the form of advice and non-binding recommendations. The White Paper notes that these functions “will not lead to third-party determinations that directly overturn the actions of elected administrations.” Instead, the emphasis lies on monitoring the functioning of the internal market.

The White Paper is silent as to the enforcement mechanism for the “mutual recognition” and non-discrimination principles. The implication is that enforcement will be through courts at the instigation of private litigants. Although courts in the UK are very familiar with the application of mutual recognition, non-discrimination and proportionality principles, the outcome in any given case may be difficult to predict and may be controversial as the litigation over minimum unit alcohol pricing in Scotland demonstrated.

Greater clarity is needed as to the role of courts in the enforcement of the proposed legislation and, in particular, what remedies will be available, including to disapply rules that breach the market access commitment and/or an ability to obtain damages.

External Trade

The White Paper locates its proposals in the context of the competence of the UK Government for international relations and the responsibilities of devolved administrations to observe and implement the UK’s international obligations. For the UK Government, a well-functioning internal market facilitates its ability to enter into ambitious new trade deals while making the UK an attractive location for foreign investment.

There are mechanisms contained in the Scotland Act to ensure that the UK's international obligations are complied with but the White Paper does not elaborate what, if any, alternative mechanisms might be desirable to manage an internal trade policy where competences are divided with an external trade policy which is reserved to the UK Government.

Interaction with Common Frameworks

The White Paper suggests that the market access commitment will provide a “baseline level of regulatory coherence” complemented by common frameworks. Where common frameworks do not exist or are partial in scope, the White Paper also suggests that the market access commitment will afford a “low-level regulatory coherence.”

What is not apparent is what happens if it is claimed that the rules in a jurisdiction conflict with the market access commitment but which are defended as compatible with or even the product of intergovernmental cooperation through common frameworks.

Precedents

A number of examples of internal market precedents are noted in the White Paper. These include non-EU states like Australia and Switzerland, as well as the EU example of Spain (although Belgium would also be an example of an EU state with legislation on the division of responsibilities for an internal market within a federal state).

The Swiss precedent appears to be a particular source of inspiration for the approach proposed.

The Swiss Internal Market

Article 94 of the Swiss Constitution refers to a “unified Swiss economic area”. The concept is not legally defined but instead confers a legislative power on the Confederation in respect of economic activities in the private sphere (with a particular focus on the recognition of professional qualifications across Cantons). The concept of a unified economic area is given more specific effect in the **federal law on the internal market of 1995**.

The Act confers a right of access to, and non-discrimination within, the Swiss market in particular by facilitating professional mobility and economic exchange; supporting efforts by the Cantons to harmonise conditions authorising access to the market; reinforcing economic competitiveness and economic cohesion. This also reinforces the right to “economic freedom” conferred by Article 27 of the Constitution. A number of important sectors are, however, excluded from the internal market, while even in areas within its scope, limited federal harmonisation leaves the Cantons with significant regulatory autonomy.