Identification and Assessment of the Legal Implications of an Entrepreneurial Reform Agenda

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Abbreviations

CCCTB – Common Corporate Consolidated Tax Base

CFSP – Common Foreign and Security Policy

CJEU – Court of Justice of the European Union

ECB – European Central Bank

ECJ – European Court of Justice

EPL – Employment protection legislation

EPSCO – Employment, Social Policy, Health and Consumer Affairs Council configuration

ESM - European Stability Mechanism

EU – European Union

FIRES – Financial and Institutional Reforms for an Entrepreneurial Society

MoU – Memorandum of Understanding

OMC – Open Method of Coordination

OSCE – Organization for Security and Co-operation in Europe

R&D – Research and development

REFIT – Regulatory Fitness Program

SMEs – Small and Medium-sized Enterprises

TEU – Treaty on the European Union

TFEU – Treaty on the Functioning of the European Union

UN – United Nations

VC – Venture capital

FIRES

1. Executive summary

In the present study, we analyzed the legal implications of the FIRES agenda to reform the EU's entrepreneurship policy, as laid out in FIRES Deliverable 2.1 – Institutional Reform for Enhanced Innovation and Entrepreneurship: An Agenda for Europe.[1] The aims of this study were threefold: (1) to determine whether the regulatory powers needed for implementing the recommendations made in Deliverable 2.1 lied at the EU level or at the national level of government; (2) to assess whether the recommendations were consistent with existing EU law and policy and whether there are any international conventions that would constrain their implementation; and (3) to determine if the recommendations should be addressed primarily to the EU institutions or primarily to the Member States, or to both levels of government equally.

According to the principle of conferral, the EU may only take a particular action to the extent that the Treaties authorizes it to do so. The EU's use of the competences bestowed upon it by the Treaties must be compliant with two other principles. Pursuant to the principle of subsidiarity – applicable only in areas not covered by EU exclusive competences – the EU may only act insofar as the objectives of the proposed action cannot be sufficiently achieved at the national level. In addition, the principle of proportionality requires that EU actions not exceed what is necessary for attaining the objectives of the Treaties. All competences not granted by the Treaties to the EU remain with the Member States.

Based on the division of regulatory powers between the EU level and the national level of governance, we concluded that the Member States are generally the best placed to implement the majority of the recommendations proposed in Deliverable 2.1. Having surveyed the powers granted to the EU in each of the relevant policy areas, we are of the view that the greater part of the recommendations should primarily be addressed to the national governments, rather than to the EU institutions. That is the case with the recommendations pertaining to 6 out of the 11 policy areas considered. Nonetheless, the fact that certain recommendations should primarily be addressed to the Member States does not mean that the EU lacks any ability to contribute to the implementation of those recommendations. In the areas where the EU lacks meaningful powers to enact binding legislation, or to harmonize national laws, it may still influence the policies of Member States by means of issuing recommendations or by organizing policy coordination processes.

Finally, we found that the proposed policy actions were largely consistent with existing EU law and policy. In fact, in many of the considered policy areas, the EU has already been pursuing, or at least advocating for policy objectives similar to those underlying the FIRES recommendations made in Deliverable 2.1. Regarding the consistency of the recommendations with international law, we have

[1] Niklas Elert, Magnus Henrekson and Mikael Stenkula, *An Institutional Framework for Innovation and Entrepreneurship/ Institutional Reform for Enhanced Innovation and Entrepreneurship: An Agenda for Europe,* FIRES Deliverable 2.1, January 2017.

not identified any international instrument that would impose any meaningful constraints on their implementation.

2. Introduction

In the present study, we analyze the legal implications of the agenda to reform the EU's entrepreneurship policy as proposed in the context of the FIRES project. The policy recommendations set out in FIRES Deliverable 2.1 – *Institutional Reform for Enhanced Innovation and Entrepreneurship: An Agenda for Europe* –[2] served as the starting point of, and main input into, our analysis. Deliverable 2.1 laid down a number of recommendations concerning the following policy areas: (1) taxation policy; (2) the rule of law and the protection of property rights; (3) regulations governing savings, capital and finance; (4) the organization of labor markets and social insurance systems; (5) the regulation of goods and services markets; (6) bankruptcy and insolvency law; (7) incentives for human and capital investment; (8) R&D, commercialization and knowledge spillovers; and (9) informal institutions. With the exception of the recommendations concerning informal institutions, which by their very nature fall outside the scope of the formal legal framework, we analyzed all other policy areas mentioned in Deliverable 2.1, though not necessarily in the order in which they were addressed in that study.

In line with the mandate for this deliverable,[3] we applied the following analytical framework. When addressing each policy area, we first determined whether the requisite legislative power to implement the recommendations set out in Deliverable 2.1 lied at the EU level of governance, the Member States level, or whether both the EU and the Member States had legislative or regulatory powers in the policy area of concern. Where appropriate, we also considered soft law (*i.e.,* non-binding) instruments and coordination processes that the EU may use for influencing the Member States' policies for purposes of implementing the FIRES recommendations. Non-binding instruments – such as recommendations addressed to the Member States by the EU institutions, coordination processes that may take the form of exchanges of best practices between Member States, setting common (non-binding) goals coupled with EU and peer review, etc. – may be particularly useful where the EU has no competence to legislate or where it only enjoys limited competence. In addition, we inquired into whether the recommendations were consonant or in conflict with existing EU law or policy, illustrating with examples of EU legislation or policy statements. We generally found

[2] Ibid.

[3] FIRES project proposal, p. 44.

the recommendations to be consistent with EU law and policy. Moreover, in many of the considered policy areas, the EU is already implementing or advocating for policies of the type contemplated in Deliverable 2.1. Aside from checking for conflict with EU law and policy, we also considered whether there were international legal instruments that may restrict the EU's, or the Member States', ability to implement the recommendations. However, we have not identified any such international law that would constrain in a significant manner the implementation of the recommendations. Finally, based on the division of competences between the EU and the Member States, and taking into account the legislative and soft law initiatives already taken by the EU, we determined whether the recommendations pertaining to each policy area should primarily be addressed to the EU institutions, to the Member States, or to both levels of government equally.

In Section 3 of this study, we provide an explanation of the general division of competences between the EU and the Member States. Following are 8 sections in which we analyze the recommendations pertaining to the 8 policy areas addressed in Deliverable 2.1, excluding informal institutions. In the last section, we provide a brief summary of our analysis and our conclusions.

3. Division of powers between the EU and its Member States

Before addressing the general division of competences between the EU and the Member States, we deem it useful to briefly explain what are the binding and non-binding instruments available to the EU institutions for implementing EU policy. Pursuant to Article 288 of the Treaty on the Functioning of the European Union (hereafter, the TFEU), "[t]o exercise the Union's competences, the institutions shall adopt regulations, directives, decisions and opinions". Article 288 further clarifies that "[a] regulation shall have general application" and that "[i]t shall be binding in its entirety and directly applicable in all Member States". 'Directly applicable' means that no transposition into national law by means of a domestic act is needed, and that it may be directly invoked before the courts of the Member States – the latter is known as direct effect. As for directives, Article 288 states that "[a] directive shall be binding, as to the result to be achieved, upon each Member States to which it is addressed, but shall leave to the national authorities the choice of form and methods". Thus, in spite of being binding, directives are not directly applicable and do not have direct effect. In order to be applicable, directives need to be transposed into the realm of national law by a legislative or regulatory act of the Member State. However, where Member States do not transpose directives in due time, or where they incorrectly transpose them, their provisions may gain direct effect under certain conditions. Regarding decisions, Article 288 provides that they "shall be binding in [their]

entirety". An important point to make with respect to decisions is that where they have a specific addressee – for instance the companies investigated in an antitrust case – they are only binding on their addressee. Finally, "[r]ecommendations and opinions shall have no binding force" (Article 288). At this point, it is worth mentioning that the EU institutions may use binding instruments, such as decisions, in order to organize non-binding policy coordination processes or to incentivize the organization of such processes. Throughout this paper we also refer to other types of documents issued by the EU institutions, for instance, Commission communications or Council conclusions. To be clear, such instruments are merely policy documents, and hence non-binding.

The distribution of powers, or competences, between the EU level of government and the Member State level is governed by the Treaty on the European Union (hereafter, TEU) and the TFEU. The EU can take a particular action – whether legislative, administrative or in the nature of soft-law (*e.g.,* recommendations) – only to the extent that Member States granted it the relevant competence by way of a treaty provision. According to the 'principle of conferral', enshrined in Article 5(2) of the TEU, "the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objective set out therein". Article 5(2) further clarifies that "competences not conferred upon the Union in the Treaties remain with the Member States".[4]

Whereas the principle of conferral circumscribes the scope of EU competences, in terms of the matters with respect to which the EU can act, the TEU also sets limits on the manner in which the EU exercises the competences conferred upon it. An important such limit is the 'principle of subsidiarity', which constrains the use of the EU's non-exclusive competences.[5] Thus, "in areas which do not fall within its exclusive competence, *the Union shall act only if and 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, by reason of the scale or effects of the proposed action, be better achieved at Union level" (Article 5(3) TEU, emphasis added). A further constraint on the use of EU competences is the 'principle of proportionality', which requires that EU action be limited to "what is necessary to achieve the objective of the Treaties" (Article 5(4) TEU).[6]

[4] See also Article 4(1) TEU.

[5] As explained below, the EU has certain competences which, in principle, can be exercised exclusively by the EU. That is, Member States cannot take measures with respect to the matters concerned. Exclusive competences are, quite obviously, not subject to the requirements of the principle of subsidiarity.

[6] The two principles are further developed in Protocol No. 2, to the TEU and TFEU, on the Application of the Principles of Subsidiarity and Proportionality.

The competences conferred upon the Union are classified into three principal categories: (1) exclusive competences; (2) shared competences; and (3) competences to carry out actions to support, coordinate or supplement the actions of the Member States.

Exclusive competences

Article 3 of the TFEU grants the Union exclusive competence with respect to the following matters:

1. the customs union;
2. competition law necessary for the functioning of the internal market;
3. the monetary policy of the Eurozone;
4. the conservation of marine biological resources under the common fisheries policy; and
5. the common commercial policy.

It should be noted that the list of areas covered by exclusive competence is exhaustive. Where a matter falls within the EU's exclusive competence, it is only the EU that can legislate or adopt legally binding acts with respect to that matter, in principle to the exclusion of Member State action. Nonetheless, the EU may authorize Member States to put in place national measures in areas covered by its exclusive competence. For instance, Member States have been empowered to regulate, under certain conditions, with respect to fisheries and the common commercial policy.[7] In addition, Member States may be called to enact laws and regulations in order to implement Union legislation falling within the latter's exclusive competence (Article 2(1) TFEU).

Shared competences

In the areas of shared competence, both the EU and the Member States are entitled to regulate. However, not at the same time. The EU enjoys a right of pre-emption over Member States when it comes to the exercise of shared competences. Pursuant to Article 2(2) TFEU, a Member State may take action in an area of shared competence only to the extent that the Union has not exercised its competence in that area. In other words, if an area is regulated at the EU level, the Member States must abstain from also regulating that area at national level. Member States may, nonetheless,

[7] Damian Chalmers, Gareth Davies and Giorgio Monti, *European Union Law,* Cambridge University Press, 3rd edition, 2014, pp. 210 and 211.

regulate aspects of the area that are not addressed by the EU legislation.[8] In addition, where EU action takes the form of minimum harmonization – that is, the EU act established minimum requirements – Member States may enact legislation setting stricter requirements.[9] Nonetheless, the Member States will regain their right of exercising a shared competence, to the extent that the Union has ceased to exercise that competence, for instance by repealing EU legislation covering the relevant area.[10]

Article 4(2) of TFEU provides that the EU shares competences with the Member States "in the following *principal* areas" (emphasis added):

a) internal market;
b) social policy, for the aspects defined in the TFEU;
c) economic, social and territorial cohesion;
d) agriculture and fisheries, excluding the conservation of the marine biological resources;[11]
e) environment;
f) consumer protection;
g) transport;
h) trans-European networks;
i) energy;
j) area of freedom, security and justice; and
k) common safety concerns in public health matters, for the aspects defined the TFEU.

The use of the phrase "principal areas" indicates that the list contained in Article 4(1) is indicative and not exhaustive,[12] as opposed to the list of exclusive competences. This means that there may be areas of shared competence other than the ones mentioned by Article 4(1). However, the EU can only have a particular competence if the Treaties conferred it upon it, as explained above. Hence, if an EU power enshrined in a provision of the Treaties seems to neither relate to an area of exclusive competence, as listed in Article 3 TFEU, nor to an area belonging to the category of competences to support, coordinate or supplement Member State Action, as listed in Article 6 TFEU, then that power is a shared competence even if it is not part of the list in Article 4(2). This is made clear by Article 4(1) TFEU, which provides that "[t]the Union shall share competence with the Member States where the

[8] Protocol No. 25, to the TEU and TFEU, on the Exercise of Shared Competences.
[9] Paul Craig and Gráinne de Búrca, *EU Law: Text, Cases and Materials*, Oxford University Press, 6th edition, 2015, p. 85; Chalmers et al., n. 8 above, p. 212.
[10] Declaration No. 18 in relation to the delimitation of competences, attached to the Treaty of Lisbon.
[11] As mentioned, the conservation of marine biological resources is an exclusive competence of the EU.
[12] Craig and de Búrca, n. 10 above, p. 83.

treaties confer on it a competence which does not relate to the areas referred to in Articles 3 and 6". For this reason, shared competences have been described as a "general residual category".[13]

As a further matter, there are certain areas of shared competences where action by the EU does not pre-empt the Member States' exercise of the competence. Thus, the EU and the Member States can act at the same time in the areas of "research, technological development and space" (Article 4(3) TFEU), and in the areas of "development cooperation and aid" (Article 4(4) TFEU). Because in these areas the EU and a Member State can each pursue its own policies, the powers provided for in paragraphs (3) and (4) of Article 4 TFEU are known as 'parallel competences'. Nevertheless, when exercising such competences, Member States are under an obligation not to obstruct EU objectives.[14]

Competences to coordinate, support or supplement the Member States' actions

Article 6 of the TFEU provides that "the Union shall have competence to carry out action to *support, coordinate or supplement* actions of the Member States" (emphasis added). The following areas are covered by such competences:

1. protection and improvement of human health;
2. industry;
3. culture;
4. tourism;
5. education, vocational training, youth and sport;
6. civil protection; and
7. administrative cooperation.

The competences belonging to this category are the weakest among the three principal categories of competences. Member States retain their power to regulate these policy areas at the national level. As clarified by Article 2(5) of the TFEU, the Union's exercise of its competences in these areas does not supersede the Member States' competences. The same provision also stipulates that "[l]egally binding acts of the Union adopted on the basis of the provisions of the Treaties relating to these areas *shall not entail harmonization of Member state's laws or regulations*" (emphasis added). Hence, harmonization in these area is quite clearly excluded. Examples of types of actions that may be taken under Article 6 are: preparing guidelines, recommendations, indicators and best practices;

[13] Ibid.
[14] Chalmers et al., n. 8 above, pp. 212 and 213.

organizing exchanges of best practices; conducting monitoring and evaluations; measures concerning early warning; etc.[15]

Economic, employment and social policies

Aside from powers falling within the scope of the three main categories of competences addressed above, the EU was also given powers to ensure the coordination of the Member States' economic, employment and social policies. Thus, Article 5(1) of the TFEU requires that Member States coordinate their *economic policies*, and empowers the Council of the European Union (hereafter, Council) to adopt measures to that end, "in particular broad guidelines". The reference to the Council only would suggest that Article 5(1) excludes legislative action by the Union, as such action would also require the participation of the European Parliament. With regard to employment policies, Article 5(2) mandates, this time, the Union - not the Council - to take measures to ensure the coordination of Member States' policies, "in particular by defining guidelines". It would appear that by referring to the Union, the second paragraph does not, on its face, exclude legislative action, in spite of the reference to guidelines. Also, the use of the phrase 'in particular' suggests that actions other than issuing of guidelines may be taken by the Union under Article 5(2). Finally, Article 5(3) provides that "[t]he Union may *take* initiatives to ensure coordination of Member State's policies".

It should be noted that there's a manifest area overlap between the competences established by Article 5 and the competences belonging to the three principal categories of powers. For instance, social policy is also covered by shared competence, albeit only for the particular "aspects defined in the Treaty" (Article 4(2)(b) TFEU). Similarly, certain aspects of economic policy are also covered by shared competences, while others by exclusive competences.

The flexibility clause

Notwithstanding the principle of conferral, the TFEU provides for a flexibility mechanism that allows the EU to act, under certain conditions, even where the Treaties have not explicitly conferred upon it the requisite powers to act. According to Article 352(1) of the TFEU:

> If action by the Union should prove necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, shall adopt the appropriate measures.

As the objectives of the Treaties are quite broad, the so-called 'flexibility clause', enshrined in Article 352, gives the Union ample opportunity to act outside of the confines of the powers expressly

[15] Ibid, p. 87. See also Article 168, paragraphs 2 and 5, of the TFEU.

bestowed upon it by the Treaties. However, the use of Article 352 is subject to certain conditions meant to constrain the potential abuse of this provision.[16] First, the above-quoted paragraph 1 makes it clear that Article 352 justifies only actions that fall within the framework of the policies defined in the treaties. Second, EU measures justified on the basis of the flexibility clause can only be taken if the Council unanimously decides to do so. As the flexibility clause allows for EU actions that are not explicitly contemplated by the Treaties, such actions must have the backing of all Member States' in the Council. The obvious implication of that is that any Member State, no matter how small, can block the use of the flexibility clause. Third, whenever the European Commission (hereafter, the Commission) submits a proposal to the Council to use the flexibility clause, it must draw the attention of the Member States' National Parliaments, so they can assess its compliance with the principle of subsidiarity and state their objections, should they deem the proposal inconsistent with the principle (Article 352(2)). Fourth, actions taken on the basis of Article 352 cannot entail the harmonization of national laws and regulation in areas where the Treaties preclude harmonization (Article 353(3)). Finally, the flexibility clause cannot be used in order to pursue objectives pertaining to the EU's Common Foreign and Security Policy (Article 352(4)).

4. Taxation

Tax policy affects entrepreneurial activity in two main ways. First, an absolute increase in the taxes borne by entrepreneurs lowers their net returns, which in turn has a bearing on how many people choose to pursue entrepreneurial activities and on the intensity of the effort they put into such activities. Moreover, a higher level of taxation hinders expansion financed by way of retained earnings.[17] On the whole, absolute increases in the level of taxation "frustrate entrepreneurial activity and impede[…] the emergence of new startups and the expansion of firms".[18] Second, the level of taxation "influences an individual's choice of occupation and organizational form", as tax policy may favour certain economic activities over others.[19]

[16] The current version of the flexibility clause, enshrined in Article 352 TFEU, has four paragraphs detailing the conditions under which the clause may be used. In contrast, the previous version of the flexibility clause, provided for in Article 308 of the Treaty Establishing the European Economic Community, had only one paragraph. Given the Member States' concern that the EU was over-using the flexibility clause additional conditions were added to Article 308, by means of the Treaty of Lisbon, resulting in what is today Article 352.
[17] Elert et al., n. 2 above, pp. 26-27.
[18] Ibid., p. 27.
[19] Ibid.

Depending on a number of factors, income derived from entrepreneurial activities may be taxed as labour income, corporate income, current capital income (dividends and interest), or as capital gains.[20]

4.1. General recommendation on taxation

> "While tax rates should generally be low or moderate, policy makers should strive for simplicity rather than (targeted) exceptions and for a high degree of tax neutrality across owner categories, sources of finance, and different types of economic activities."[21]

In order to determine whether the EU has competence with respect to a particular policy area, one first needs to look whether that area is mentioned by the provisions of Title I, Part One of the TFEU, laying down the "Categories and areas of Union Competence" (Articles 2-6). As explained above, Articles 2 through 6 of the TFEU list the policy areas with respect to which the EU has competence, and define the type of competence pertaining to each of the listed areas – that is, whether the competence is exclusive, shared, or to support, coordinate or supplement the actions of Member States.[22] In addition to the provisions of Title I, Part One, subsequent sections of the TFEU further develop on the scope of the EU's powers relating to the policy areas listed in Articles 3-6. Thus, for every policy area mentioned in Title I there is a dedicated title, or chapter, in the TFEU setting down detailed rules for that area.

Although tax policy is not mentioned by any of the provisions in Part One, Title I (i.e. Articles 2-6 TFEU), the treaty features a chapter titled 'Tax provisions'. However, none of the provisions in that chapter grant the EU powers to harmonize national policies concerning direct taxation. Instead they pertain to: (1) the non-discriminatory taxation of products imported from other EU Member States, as compared to domestically-produced similar products (Article 110 TFEU); (2) the repayment of internal taxes where products are exported to other Member States (Articles 111 and 112 TFEU); and (3) the harmonization of national legislation concerning turnover taxes, excise duties and other forms of *indirect taxation*, to the extent necessary for the establishment and functioning of the internal market[23] (Article 113 TFEU). In the general scheme of categories and areas of EU competences, the tax provisions contained in Articles 110 to 113 TFEU fall under the competences

[20] Ibid.

[21] Ibid., pp. 4 and 83.

[22] See Section 3 above.

[23] The internal market is defined as "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" (Article 26 TFEU).

pertaining to the regulation of the internal market, which is a shared competence (Article 4(2)(a) TFEU).

More specifically, Article 110 TFEU imposes on Member States a non-discrimination obligation with respect to taxation. That means that Member States are prohibited from taxing goods imported from other Member States in excess of the taxes levied on similar products that are of domestic origin. In addition, Member States must also not apply taxes to products imported from other EU Members in such a manner as to indirectly afford protection to other products. To be noted is that taxes in the context of the 'tax provisions' of the TFEU means internal taxes and does not include customs duties. Another clarification worth making is that Article 110 only concerns the taxation of goods, normally done by means of indirect taxation, and not direct taxes on income or profits.[24] Moreover, each Member State is in principle free to decide what to tax and at what level,[25] as long as they don't dissimilarly tax similar, or otherwise competing products, to the detriment of imports from other Member States. Basically, Article 110 precludes Member States from using taxation policies in order to give domestic products a competitive advantage over imported products. In the words of the ECJ, Article 110 "must guarantee the complete neutrality of internal taxation as regards competition between domestic products and imported products from other Member States".[26]

Whereas Article 110 is concerned with protecting the competitive opportunities of the exports of a Member States in relation to the domestic goods of an importing Member State, Article 111 TFEU aims at protecting the domestic goods of an importing Member State from a potentially unfair advantage that may be enjoyed by the exports of another Member State. Thus, where a product is exported from one Member State to another, Article 111 enjoins Member States from repaying internal taxation in excess of the taxes that had been imposed on that product. Article 111 refers to a situation of border tax adjustment, whereby internal taxes imposed on a product are paid back to the exporter of that product upon exportation. If Member States were allowed to pay the exporters back more than the amount of tax levied on that good, such a payment would be a subsidy that would confer an unfair advantage to that product.

Furthermore, Article 112 prohibits Member States from repaying taxes other than "turnover taxes, excise duties and other forms of indirect taxation", when goods are exported to other Member

[24] Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms*, Cambridge University Press, 4th edition, 2010, p. 53.
[25] Ibid.
[26] C-193/85, *Cooperativa Co-Frutta Srl v Amministrazione delle finanze dello Stato*, para. 25.

States, and from imposing "countervailing charges in respect of imports from Member States", unless the contemplated measures have previously been approved by the Council.

Finally, Article 113 grants the EU the power to harmonize national "legislation concerning turnover taxes, excise duties and other forms of *indirect taxation*" (emphasis added) to the extent that that is necessary for ensuring the establishment and functioning of the internal market, and for avoiding distortions of competition.

The 'Tax provisions' of the TFEU mainly concern indirect taxation, and chiefly institute prohibitions on certain policies that may affect competition in the internal market; except for Article 113 which grants the EU the competence to take action and harmonize national laws regulating indirect taxation, should that be necessary for the functioning of the internal market. To be sure, Article 113 does not allow the EU to legislate on matters of direct taxation. In principle, direct taxation is considered to be outside the scope of EU competences[27], meaning that Member States are by and large free to adopt whatever tax policies they wish, as long as they don't breach the requirements of Articles 110 to 112, and the provisions of the TFEU establishing the four freedoms: the free movement of goods, services, persons and capital.[28] As explained in a communication issued by the Commission in 2009, "Member States are, under Community law, largely free to design their direct tax systems in a way that best meets their domestic policy objectives and requirements".[29] Additionally, a brochure explaining the EU's policies with respect to taxation, which was published by the Commission in 2015, states that "the power to raise taxes and set tax rates lies with the national governments".[30]

Aside from the chapter on 'Tax provisions', there are two other provisions in the TFEU that explicitly refer to the EU's competence, or to be more precise, the EU's lack of competence over the Member States' tax policies. Article 114 TFEU bestows upon the EU the power to harmonize national laws in order to ensure the establishment and functioning of the internal market. In the words of Article 114, the EU shall "adopt the measures for the approximation of 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". The powers conferred on the EU by Article 114, known as 'the harmonization

[27] Craig and de Búrca, n. 10 above, p. 86.
[28] Ibid.
[29] *Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee: Promoting Good Governance in Tax Matters*, COM(2009)201 final, 28 April 2009, p. 5.
[30] European Commission, *The European Union Explained: Taxation*, January 2015, p. 3.

clause',[31] are rather broad and sweeping. On top of that, when adopting legislation on the basis of Article 114, the EU acts in accordance with the ordinary legislative proposal, which only requires qualified majority[32] as a voting requirement in the Council; this means that there is no need for all Member States to agree upon the adoption of the legislative act in question. However, the second paragraph of *Article 114 explicitly carves out tax policy from its scope of application*, providing that it "shall not apply to fiscal provisions". Hence, the harmonization clause cannot be used as a legal basis for harmonizing national tax policies.

Another provision mentioning taxation is Article 173 TFEU, which develops upon the EU's competence to support, coordinate or supplement the actions of Member States with respect to certain aspects of industrial policy. In addition to policy coordination (*e.g.*, preparing guidelines and indicators, organizing exchanges of best practices, etc), Article 173 also contemplates take legislative actions taken by the EU in support of the Member States' actions. However, the second paragraph of Article 173(2) precludes EU measures touching upon tax policy, by explicitly providing that Article 173 "shall not provide a legal basis for the introduction by the Union of any measure which […] contains tax provisions […]".

Although "the EU has no [explicit] competence over matters such as direct taxation",[33] it sometimes uses a vague provision in the treaty in order to adopt legislation touching upon direct taxation – for instance, legislation concerning administrative cooperation between Member States on tax matters, including direct taxation. An example is Council Directive 2011/16 on administrative cooperation in the field of taxation, laying down "rules and procedures under which the Member States shall cooperate with each other with a view to exchanging information that is foreseeably relevant to the administration and enforcement of the domestic laws of the Member States concerning […] all taxes of any kind levied by, or on behalf of, a Member State" (Articles 1(1) and 2(1)). It seems that the main objective of the directive was to enable Member States to better address international tax evasion and tax avoidance. To be noted is that the procedures established by the directive apply to both indirect and direct taxation, as suggested by the phrase "all taxes of any kind" used in Article 2(1), but also as made explicit in its preamble (recital 6). Another example of EU legislation touching upon

[31] This is in spite of Article 114 referring to the approximation of national laws, not harmonization. Since the two terms are generally used in EU legal scholarship interchangeably, we use the term harmonization throughout this paper, even where the cited legal provision refers to approximation.
[32] Qualified majority is defined by Article 16(4) of the TEU "as at least 55% of the members of the Council, comprising at least fifteen of them and representing Member States comprising at least 65% of the population of the Union".
[33] Craig and de Búrca, n. 11 above, p. 86. The fact that direct taxation is generally a competence retained by the Member States has also consistently been recognized in the jurisprudence of the Court of Justice of the European Union. See for instance case C-35/98, Staatssecretaris van Financiën v B.G.M. Verkooijen, para. 32.

direct taxation is Council Directive 2010/24 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures. The purpose of the directive is to establish procedures whereby the fiscal authorities of a Member State can request the assistance of the authorities of another Member State for recovering tax debts, where the debtor resides in the territory of the latter Member State, or where the recoverable assets are within that Member State's jurisdiction. The provisions of the directive apply to "all taxes and duties of any kind levied by or on behalf of a Member State or its territorial or administrative subdivisions, including the local authorities, or on behalf of the Union" (Article 2(1)(a)). It is clear from the use of the phrase "all taxes and duties", that both indirect and direct taxation falls within the scope of the directive.

Both of the aforementioned directives have the same two legal bases. The first one is Article 113 TFEU, which, as explained above, allows the EU to adopt harmonization measures concerning indirect taxation that are necessary to ensure the functioning of the internal market and to avoid distortions of competition. As Article 113 could not serve as a legal basis for the adoption of harmonization measures concerning direct taxation, the EU also relied on Article 115 TFEU, a provision similar to the harmonization clause (*i.e.*, Article 114). Article 115, just like Article 114, allows the EU to harmonize national laws. Whereas Article 114 mandates the adoption of harmonization measures "which have as their object the establishment and functioning of the internal market", Article 115 requires the EU to harmonize those national laws, regulations or administrative provisions that "*directly affect* the establishment and functioning of the internal market" (emphasis added). For the purposes of this paper, the main difference between Article 114 and Article 115, is that the latter does not exclude tax policy from its scope of application. However, the national laws subject to harmonization must directly affect the functioning of the internal market. In any case, it is not obvious how the laws harmonized by the two directives mentioned above *directly* affected the functioning of the internal market. However, that is outside of the scope of concerns of this paper; the point to be taken is that, in principle, Article 115 could be (and is) used as a legal basis for harmonizing national tax policies. Although Article 115 has been used several times, solely, or in conjunction with Article 113, as a legal basis for directives[34] concerning direct taxation, it has never been used, to our best knowledge, in order to harmonize tax rates in Member States. That being said, there is another important difference between Articles 114 and 115 that must be mentioned. The adoption of legislation by the EU under Article 115 requires unanimity in the Council – as it does under Article 113. This means that any Member State can block the adoption of the piece of legislation at issue, which, quite obviously, makes Article 115 more difficult to use.

[34] A directive is a binding legislative act of the European Union that must be transposed by Member States into national legislation. The directives are the tools used by the EU for purposes of harmonizing national laws.

According to the European Commission, "unanimity for all taxation decisions makes it difficult to achieve the level of tax co-ordination necessary for Europe".[35]

The following are further examples of directives concerning taxation that have Article 115 as their legal basis:

- Directive 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market;
- Directive 2014/107 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation;
- Directive 2011/96 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States;
- Directive 2009/133 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States; and
- Directive 2003/49 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

Finally, another provision that may serve as a legal basis for adopting EU legislation concerning direct taxation is the 'flexibility clause' (Article 352 TFEU), which, as explained above, allows the EU to act where the Treaties have not explicitly conferred upon it the requisite powers to attain one of the objectives of the Treaties. However, like Article 115 and Article 113, the use of Article 352 also requires unanimity in the Council.

Even though the harmonization of national direct taxation policies could, in theory, be done on the basis Article 115 (or even on the basis of Article 352), one may safely assume that Member States are likely to be very protective of their regulatory autonomy when it comes to tax policy. The Member States' attitude in this respect is illustrated by their reaction to the Commission's proposal - made during the negotiations of the failed 'Treaty Establishing a Constitution for Europe' – to abandon the unanimity rule for legislation concerning certain tax matters,[36] and agree, instead, to subject decisions on such matters to a qualified majority rule.[37] The Member States rejected the

[35] Website of European Commission, Directorate General for Taxation and Customs Union, http://ec.europa.eu/taxation_customs/general-information-taxation/eu-tax-policy-strategy_en.

[36] "e.g. taxation in connection with the operation of the internal market, i.e. modernising and simplifying existing legislation, administrative cooperation, combating fraud or tax evasion, measures relating to tax bases for companies, but not including tax rates; […] taxation in respect of the environment; […]" (Communication from the Commission, *A Constitution for the Union: Opinion of the Commission, pursuant to Article 48 of the Treaty on European Union, on the Conference of representatives of the Member States' governments convened to revise the Treaties*, COM(2003) 548 final, 17 September 2003, p. 7, bold added).

[37] Website of European Commission, Directorate General for Taxation and Customs Union, above n. 36. See also Communication from the Commission, above n. 37, p. 7. The Commission had also expressed this view in a previous

Commission's proposal. As acknowledged by the Commission in a communication from 2006 concerning the co-ordination of national tax systems, "[a]s Community law currently stands, Member States remain largely free to design their direct tax systems so as to meet their domestic policy objectives and requirements".[38] Although, in the meantime, the EU treaties have been amended by the Treaty of Lisbon, the situation remains the same. According to a more recent statement (from 2005), "[n]ational governments are broadly free to design their tax laws according to their national priorities".[39]

In conclusion, the EU only enjoys limited legislative powers with respect to direct taxation. A concise description of what can be achieved by the EU in this area by means of binding legislation can be found in the Commission's brochure on tax policies, which reads the following:

> Legislation in the direct tax area is limited to bringing the different laws in each EU country more in line with each other (approximation of laws). This can only be done to the extent necessary to improve the functioning of the European Union's internal market and address common cross-border challenges such as tax evasion.[40]

Soft law

In addition to legislative action, the EU can use a number of soft law (*i.e.,* non-binding) instruments and approaches in order to influence the tax policies of Member States. Such instruments include: recommendations; policy statements developed by the Council and non-binding agreements between Member States, coupled with regular assessments and peer pressure; exchanges of best practices between Member States; etc.

An example of a recommendation concerning the tax policies of Member States is Commission Recommendation 2009/784 on withholding tax relief procedures – adopted on the basis of former Article 211 of Treaty Establishing the European Community (hereafter TEC).[41] The objective of the recommendation was to propose "improvements to the procedures of the Member States for granting withholding tax relief on cross-border securities income earned by investors who are resident in the Community" (Article 1.1). Article 211, which granted the Commission a general

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communication, stating that "it remains the Commission's view that a move to qualified majority voting at least for certain tax issues is indispensable, and in particular when there are serious distortions of the internal market" (*Communication from the Commission to the Council, the European Parliament and the European and Economic and Social Committee: Tax policy in the European Union – Priorities for the years ahead*, COM(2001)260, 21 May 2001).

[38] *Communication from the Commission to the Council, the European Parliament and the European and Economic and Social Committee: Co-ordinating Member States' direct tax systems in the Internal Market*, COM/2006/823, 19 December 2006, p. 3.

[39] European Commission, *The European Union Explained: Taxation*, January 2015, p. 4.

[40] Ibid., p. 3.

[41] The TEC was renamed as the Treaty on the Functioning of the European Union pursuant to the changes brought by the Treaty of Lisbon.

competence to issue recommendations that it considered necessary with respect to matters dealt with by the Treaty, was removed by the Treaty of Lisbon from what is now the TFEU. However, the present Article 292 of the TFEU gives the Council such a general power to adopt recommendations.[42] Hence, Article 292 could serve as a legal basis for recommendations on tax policy addressed to Member States.

Article 292 also refers to the Commission's competence to adopt recommendations "in the specific cases provided for in the Treaties". This means that the Commission would need to rely on a more specific legal basis, in conjunction with Article 292, in order to validly issue a recommendation. Nevertheless, there are examples of Commission recommendations where the Commission relied on Article 292 alone.[43] Hence, the Commission could try to rely on Article 292 to issue recommendations on tax policy, even though this would constitute an improper use of Article 292.

The European Semester

The EU often issues Member State-specific recommendations on tax policy in the context of the so-called European Semester[44] – a process used for coordinating and surveilling the Member States' economic policies that is mainly concerned with the macro-economic health of national economies. Introduced in 2010, the European Semester provides Member States with a framework for discussing their economic and budgetary plans in the first half of every year (hence the name European Semester), leaving the second semester for the implementation of the country-specific recommendations adopted by the Council, particularly with respect to the adoption of the national budgets for the next year. The process relies heavily on the Commission's analysis of the economic policies of each Member States and on its country-specific recommendations, but it also gives Member States and opportunity to comment on each other's planned policies and discuss common challenges.[45] Very broadly, the European Semester is concerned with three areas of policy coordination: fiscal policies, needed to ensure the sustainability of public finances; structural

[42] An example of a recommendation adopted solely on the basis of Article 292 is Council Recommendation 2013/C 120/01 on establishing a youth guarantee.

[43] Commission Recommendation 2017/432 on making returns more effective when implementing Directive 2008/115/EC of the European Parliament and of the Council; Commission Recommendation of 28 January 2016 on the implementation of measures against tax treaty abuse, C(2016)271final.

[44] European Commission, *The European Union Explained: Taxation*, January 2015, p. 6.

[45] European Commission, *Factsheet: The EU's Economic Governance Explained, 2017,* https://ec.europa.eu/info/sites/info/files/eu-economic-governance-explained.pdf.

reforms, needed for promoting growth and employment; and the prevention of macroeconomic imbalances.[46]

The EU legislation underpinning the European Semester is based on Articles 121 and 126 of the TFEU, regulating the coordination of the Member States' economic policies, and article 136 concerning the coordination and surveillance of the economic policies of those Member States whose currency is the EURO.[47]

Since national fiscal policy is one of the main concerns of the European Semester, the country-specific recommendations issued in the context of this coordination mechanism could potentially be an adequate tool for proposing the reforms needed to improve the entrepreneurship environment in Europe.

The Open Method of Coordination

Another mechanism for coordinating national policies within the EU is the so-called 'Open Method of Coordination' (the OMC). Like the recommendations directed to Member States in the European Semester context, the OMC is in the nature of soft law.[48] The OMC can be described as a form of 'inter-governmental policy-making' that requires neither the enactment of EU legislation, nor the amendment of national legislation for purposes of implementing the objectives agreed by the Member States. The open method of coordination is used in policy areas where the EU has no competence, or only limited competence. Broadly, this form of coordination involves the adoption by the Council of (non-binding) policy goals and objectives, which should subsequently be implemented by Member States according to agreed timetables. In order to assess the implementation of the agreed policies by each Member State, the Council also develops indicators and benchmarks against which to measure the result of the implementation efforts. The outcomes are then compared to each other and Member States exchange best practices. An important element of this approach is the 'peer pressure' (sometimes going as far as 'naming and shaming') exercised by Member States on each other. Both the Commission and the European Parliament play minor roles in the process.

[46] Council website: http://www.consilium.europa.eu/en/policies/european-semester/. The page also contains and accessible infographic on the process.

[47] European Commission website: https://ec.europa.eu/info/node/4318.

[48] The coordination process entailed by the European Semester could also be said to be in the nature of the OMC.

Whereas the European Parliament may only give advice, the Commission is only involved in the monitoring and surveillance of the implementation.[49]

Given that tax policy is an area where the EU enjoys only limited competence, the use of the OMC could be an option for coordinating the tax policies of Member States in order to improve the entrepreneurship environment. The Conclusions of the Lisbon European Council (March 2000), which first defined the OMC as an EU policy instrument, explicitly stated that the OMC should be applied for "[c]reating a friendly environment for starting up and developing innovative businesses, especially SMEs".[50] Moreover, the OMC has already been used in the tax area with respect to corporate taxation – see the section on the Code of Conduct for Business Taxation below.[51]

4.2. Specific recommendations on taxation

4.2.1 Taxation of corporate income

High corporate income taxes encourage debt financed expansion to the detriment of equity financed expansion, to the extent that the cost of interest on borrowed capital is tax deductible – this is known as the *debt bias*. This disadvantages smaller enterprises, given that such firms have a higher borrowing cost than large firms and find it more difficult to access loans. As mentioned, high corporate taxes also reduce the amount of retained earnings that can be used for financing growth. Therefore, high taxes on small firms often hinders their growth rates.[52]

Recommendations

"First, the Union must be adamant about ending blatant institutional arbitrage and sweetheart deals negotiated between national governments and large multinational corporations. Additionally, the Union should strive to reduce and ideally remove the discrepancies in member countries between statutory and effective corporate income tax rates, which may result from tax-reducing depreciation rules, inventory valuation rules or other more *ad hoc* country- or industry-specific tax reductions. Their removal would create transparency and contribute to levelling the playing field for all firms regardless of their size, industry or nationality. Competition among member states is good,

[49] Martina Prpic, *The Open Method of Coordination*, European Parliamentary Research Service, October 2014; Vasilis Hatzopoulous, *Why the Open Method of Coodination is Bad for You: A Letter to the EU, 13* European Law Journal, No. 3, May 2007, p. 311.

[50] Presidency Conclusions of Lisbon European Council, 23 and 24 March 2000, paras. 14 and 15, http://www.europarl.europa.eu/summits/lis1_en.htm.

[51] The Code of Conduct on Business taxation is considered by certain scholars as belonging to the OMC (Claudio M. Radaelli, *The Open Method of Coordination: A New Governance Architecture for the European Union?*, Swedish Institute for European Policies Studies, Report nr. 1, March 2003, pp. 17 and 31-34).

[52] Elert et al., n. 2 above, pp. 27-28.

but it should be competition on corporate tax rates and not on complex, opaque fiscal deals and schemes. Member states should treat all firms equally."[53]

As illustrated below, the EU and its Member State have already taken a number of actions aimed at addressing the elements of the above FIRES recommendations on corporate taxation.

Code of Conduct for Business Taxation

As mentioned, the Open Method of Coordination (OMC) has already been used in order to coordinate certain national policies concerning corporate taxation. Thus, the "Council *and the Representatives of the Governments of the Member States Meeting within the Council*" adopted, in December 1997, a Code of Conduct for Business Taxation.[54] The code is a non-binding agreement – or in the words of the resolution containing the code, "a political commitment"[55] – between EU Member States to "curb harmful tax measures",[56] while at the same time acknowledging "the positive effects of fair [tax] competition".[57] As the Council is comprised of representatives of Member States, the fact that the Resolution on the Code of Conduct for Business Taxation was adopted by the "Council *and the Representatives of the Governments of the Member States Meeting within the Council*" emphasizes the inter-governmental nature of the process of coordination entailed by the Code, and signals that the process does not fall within the legal framework of the EU, lacking a formal legal basis in the Treaties.[58]

The Code of Conduct for Business taxation concerns "those measures [laws, regulations and administrative practices] which affect, or may affect, in a significant way the location of business activity in the Community".[59] More specifically, the Code applies to "tax measures which provide for a significantly lower level of taxation, including zero taxation, than those levels which generally apply in the Member State in question".[60] The Code further clarifies that such tax measures "are to be considered potentially harmful" and that the mentioned lower level of taxation "may operate by

[53] Ibid., p. 32.
[54] Council Conclusions of ECOFIN Council Meeting concerning taxation policy, 1 December 1997, *Annex 1: Resolution of the Council and of the Representative of the Governments of the Member States, Meeting within the Council, on a code of conduct for business taxation*.
[55] Ibid., recital 6 of preamble.
[56] Ibid., recital 5 of preamble.
[57] Ibid., recital 4 of preamble.
[58] The first paragraph of the Code also clarified that it is "[w]ithout prejudice to the respective spheres of competence of the Member States and the Community".
[59] *Code of Conduct for Business Taxation*, n. 55 above, para. A.
[60] Ibid., para B.

virtue of the nominal tax rate, the tax base or any other relevant factor".[61] The Code also contains an indicative list of criteria on the basis of which to conduct the assessment of whether a tax measure failing within its scope is harmful. The criteria listed in the Code are the following:

1. whether advantages are granted only to non-resident or in respect of transactions carried out with non-residents, or
2. whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base, or
3. whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages, or
4. whether the rules for profit determination in respect of activities within multinational group of companies departs from internationally accepted principles, notably the rules agreed upon in the OECD, or
5. whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way.[62]

The Member States undertook two main commitments under the Code. The first was a standstill commitment by which Member States agreed "not to introduce new tax measures which are harmful within the meaning of [the] code".[63] The second was a commitment to rollback exiting harmful measures. Thus, Member States committed to "re-examining their existing laws and established practices" and to "amend such laws and practices as necessary with a view to eliminating any harmful measures as soon as possible.[64]

In addition to the standstill and the rollback of harmful measures, the Member States also agreed to subject themselves to a review process. The Code provided for the establishment of a group composed of representatives of Member States that would assess the tax measures that fall within the scope of the code and oversee the provision of information by Member States.[65] The so-called Code of Conduct Group (Business Taxation) was established by the Council on 9 March 1998.[66] Furthermore, the group was mandated to meet regularly and to report to the Council on the assessed measures.[67] Its latest report to the Council is dated 12 June 2017.[68] To get an idea on the frequency of meetings, the Code of Conduct Group met three times during the first semester of 2017.[69]

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[61] Ibid.
[62] Ibid.
[63] Ibid., para. C.
[64] Ibid., para. D.
[65] Ibid., para. H.
[66] Council website: http://www.consilium.europa.eu/en/council-eu/preparatory-bodies/code-conduct-group/.
[67] *Code of Conduct for Business Taxation*, n. 55 above, para. H.
[68] Code of Conduct Group (Business Taxation), *Report to the Council*, 12 June 2017, http://data.consilium.europa.eu/doc/document/ST-10047-2017-INIT/en/pdf.
[69] Ibid., p. 2.

The Code of Conduct for Business Taxation serves to illustrate how the Open Method of Coordination can be used in the tax area. It is also an example of an EU action falling within the scope of the above FIRES recommendations on corporate taxation. Aside from the Code of Conduct, there are other initiatives taken at EU level that address elements of the FIRES recommendations on corporate taxation, the most notable of which being the Common Consolidated Corporate Tax Base (CCCTB), the Anti-Tax Avoidance Directive, the automatic exchange of information on tax rulings, and the enforcement of EU state aid law against fiscal aid, particularly in the form of tax rulings.

Common Consolidated Corporate Tax Base

The European Commission first proposed the establishment of a Common Consolidated Corporate Tax Base (CCCTB) in 2011. Broadly, the objective of the proposal was to *establish a single European set of rules for determining the corporate tax base of companies with taxable presence in several Member States*, allowing corporations to treat the entire territory of the EU as single market for tax purposes. Under the proposed rules, the individual tax base of each subsidiary or branch within a corporate group would, after being determined according to the common rules, be consolidated into an EU-wide tax base which would subsequently be apportioned to the eligible Member States. The latter would then apply their own corporate tax rates to their share of the tax base. Furthermore, the companies, or group of companies, that chose to subject themselves to the CCCTB would only be required to deal with one national tax authority.[70]

The 2011 proposal proved to be overambitious and the legislative process in the Council ground to a halt soon after it started[71] – there has been no noticeable progress in the Council since 2011.[72] It seems that the main point of disagreement between the Member States was the more complex consolidation aspect of the proposal.[73] Despite the lack of consensus in the Council, the idea of establishing a CCCTB still enjoyed much support from the European Parliament, certain Member

[70] European Commission, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB),* COM(2011)121/4, 2011.

[71] *Communication from the Commission to the European Parliament and the Council: Building a Fair, Competitive and Stable Corporate Tax System for the EU,* COM(2016)682final, 25 October 2016, p. 4.

[72] Gustaf Gimdal, *Common Corporate Tax Base (CCTB)*, European Parliamentary Research Service, Briefing on *'EU Legislation in* Progress', 4 May 2017.

[73] European Commission, *Proposal for a Council Directive on a Common Corporate Tax Base,* COM(2016)685final, 25 October 2016, Explanatory Memorandum, p. 3. Commission Communication, n. 72 above, p. 4.

States, business interests and other stakeholders. Therefore, the Commission decided in 2015 to prepare a new, politically more manageable, proposal entailing a two-step process, or a sequenced approach.[74] The Commission, thus, put forth two legislative proposals in October 2016, corresponding to its two-step approach: one for a Directive on a Common Corporate Tax Base,[75] and another for a Directive on a Common Consolidated Corporate Tax Base.[76] Essentially, the Commission is proposing that the process of developing the rules needed for establishing the CCCTB be broken into two stages. The Council would first work on developing the rules on the common corporate tax base, and only once it reached an agreement on the first proposed directive, would it move to consider the second proposal concerning the more contentious consolidation of the common tax base and the apportionment of the consolidated base to the eligible Member States.[77] The two proposals are currently under the consideration of the Council.

The two-directive package proposed by the Commission in 2016 seems to be very much in line with the FIRES recommendations on corporate taxation. According to the Commission, "the CCCTB will […] introduce complete transparency on each Member State's system and their effective tax rates".[78] "As all companies should be treated equally for tax purposes",[79] the CCCTB will also ensure that the Member States' statutory tax rates are effectively applied to all companies.[80] The Commission further claims that "[h]idden and preferential regimes and harmful tax rulings will no longer be possible", and that the Member States' incentives to engage in harmful tax competition will be removed.[81]

As opposed to the 2011 proposal, which provided for a scheme that would have been optional for all companies,[82] the 2016 proposal contemplates the compulsory application of the rules of the CCCTB to corporate groups whose consolidated group turnover exceeds EUR 750 million. Non-qualifying companies would have the possibility of choosing whether to subject themselves to the scheme or not (Article 2 of each of the two proposed directives). The 2016 package – and in particular the first proposed directive on a common tax base – differs from the 2011 proposal in another respect, one that is relevant for the purpose of the FIRES recommendations on corporate tax. Thus, the proposed

[74] Commission Communication, n. 72 above, p. 4.

[75] *Proposal for a Council Directive on a Common Corporate Tax Base,* n. 74 above.

[76] European Commission, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base,* COM(2016)683final, 25 October 2016.

[77] *Proposal for a Council Directive on a Common Corporate Tax Base,* n. 74 above, Explanatory Memorandum, p. 3.

[78] Commission Communication, n. 72 above, p. 7.

[79] Ibid., p. 6.

[80] Ibid., p. 7.

[81] Ibid.

[82] *Proposal for a Council Directive on a Common Corporate Tax Base,* n. 74 above, Explanatory Memorandum, p. 9.

directive includes provisions on a so-called ‘allowance for growth and investments’ that seek to reduce the tax systems’ bias in favour of debt-financed growth as compared to equity-financed growth. As acknowledged in the 10th recital of the preamble of the proposed directive, “[t]he fact that interest paid out on loans is deductible from the tax base of a taxpayer whilst this is not the case for profit distributions creates a definitive advantage in favour of financing through debt as opposed to equity.” According to the proposed rules against the debt bias, equity financing will be rewarded by allowing companies, under certain conditions, to make deductions from their tax base corresponding to increases in their equity base.[83]

To be clear, the CCCTB directives would not regulate national corporate tax rates. Member States retain their fiscal sovereignty and each of them remains free to set its corporate tax rates according to its needs.[84] As for the legal basis, the two directives of the CCCTB package rely on Article 115 TFEU.

Anti-Tax Avoidance Directive

Another relevant initiative, in the context of the FIRES recommendations, is the recently adopted Directive 2016/1164, of 12 July 2016, laying down rules against tax avoidance practices that directly affect the functioning of the internal market. Among other things, the Anti-Tax Avoidance Directive provides for limitations on the amount of interest paid on loans that can be deducted from a company’s tax base. The chief aim of the ‘interest limitation rule’, established by Article 4 of the Directive, is to curb base erosion and profit-shifting to low-tax jurisdictions by means of excessive interest payments on intra-corporate loans.[85] An expected side-effect of the interest limitation rule is a weakening of the national tax systems’ bias in favour of debt financing.[86] To be noted is that Member States may exclude financial undertakings from the application of the interest limitation rule (Article 4.7). The legal basis relied upon by the Council when adopting the Anti-Tax Avoidance Directive was Article 115 TFEU.

Automatic exchange of information between Member States on tax rulings

As mentioned above, the Council put in place, in 2011, a directive establishing rules and procedures for the exchange of information between Member States in the field of taxation (Directive 2011/16

[83] Ibid., pp. 3 and 10, and the 10th recital at p. 14.
[84] Commission Communication, n. 72 above, p. 7.
[85] Recitals 6 through 9 of the preamble of the Anti-Tax Avoidance Directive; European Commission, *Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market*, COM(2016)26final, 28 January 2016, Explanatory Memorandum, p. 7.
[86] Proposal for an Anti-Tax Avoidance Directive, n. 86 above, p. 7.

on administrative cooperation in the field of taxation). On 8 December 2015, the Council adopted – again, on the basis of Article 115 TFEU – Directive 2015/2376 amending Directive 2011/16 as regards *automatic* exchanges of information. By way of Directive 2015/2376 the Council extended the provisions of Directive 2011/16 concerning the mandatory exchanges of information to also cover cross-border advance tax rulings and advance pricing arrangements. A tax ruling is an act issued by the tax authorities of a Member State to a taxpayer, concerning the interpretation or application of that Member's tax laws with respect to the particular circumstances of the taxpayer. The purpose of the tax rulings is to give the taxpayers clarity and certainty as to how their tax liability will be determined by the tax authority, or with respect to the tax implications of a planned transaction. As the tax ruling is typically binding on the tax authorities, the taxpayer can rely on the ruling and later invoke it against the tax authorities, if needed. Advance pricing arrangements are a type of tax rulings that validate a company's intended transfer pricing arrangements. An aspect to be noted is that the Directive applies only to those tax rulings that have a cross-border element, for instance, transfer pricing arrangements between two related companies that are established in different Member States.[87]

Although advance tax rulings are legitimate instruments that provide businesses with certainty and clarity as to the meaning and application of tax laws, they may also be used in ways that are harmful to the interests of other Member States. For instance, a Member States may give preferential treatment to a company by means of a tax ruling, hence inducing that company to artificially shift profits to that Member State. Needless to say, the profit-shifting would occur to the detriment of the Member State where the profits were made, leading to the erosion of its tax base. Additionally, preferential tax treatments may distort competition in the internal market by bestowing upon certain market players an advantage that may not be available to its competitors[88] (see the section on state aid law below).

Pursuant to the provisions introduced by Directive 2015/2376, the tax authorities of Member States are under the obligation to communicate to the tax authorities of all other Member States a defined set of basic information with respect to the advance cross-border tax rulings and pricing arrangements they issue. Part of that information is also communicated to the Commission. The information must be communication within three months following the end of the half of the

[87] European Commission, *Proposal for a Council Directive amending Directive 2011/16 as regards mandatory exchange of information in the field of taxation,* COM(2015)135final, 18 March 2015, Explanatory Memorandum, pp. 2-3; European Commission, *Combatting corporate tax avoidance: Commission presents Tax Transparency Package,* Fact Sheet Memo, 18 March 2015, http://europa.eu/rapid/press-release_MEMO-15-4609_en.htm.

[88] Ibid. See also the first recital of the preamble of Directive 2015/2376.

calendar year during which the ruling was made. Moreover, Member States may also request further information, including the full text of the ruling (Article 8a of Directive 2016/11).

It is hoped that the enhanced transparency brought about by the mandatory exchanges of information on tax rulings will make it less likely that Member States will give preferential tax treatment to large multinationals that is harmful to the interests of other Member States. Not only that peer pressure might curb a Member State's inclination to engage in harmful tax practices – which might also breach the principles of the Code of Conduct for Business taxation – but the new mechanism increases the chances that tax rulings that are inconsistent with EU state aid law be discovered (see below). Thus, Member States will be able to identify those rulings that may qualify as state aid and report them to the Commission, which, in turn, might start an investigation. Besides, the Commission is also getting part of the information exchanged between Member States, further helping efforts to enforce EU state aid law. Moreover, better transparency will better enable the national tax authorities to fight aggressive tax planning by multinational corporations.[89]

Enforcement of State Aid Law

The EU maintains a rather sophisticated and strict system of controlling aid given by Member States to economic operators. Aid is very broadly defined as a transfer of resources from the state to an undertaking[90] that confers the latter an (unfair) advantage on the market, as compared to its competitors. The transfer of resources, or the support granted by the state, may take various forms, such as: a grant; a loan; a loan guarantee; an infusion of capital; the provision of goods and services; or the foregoing of public revenue (for instance, *tax concessions* or waiving the payment of a fine).[91] In turn, an advantage means "any economic benefit which an undertaking could not have obtained under normal market conditions, that is to say in the absence of the state intervention".[92] A state grant would confer an advantage to the recipient virtually every time, as it is highly unlikely that a company could obtain non-repayable funds other than from the state. A loan would confer an advantage if given at below market rates. The same applies to loan guarantees. Similarly, the provision of goods or services by the state at below market prices would also confer an advantage to the company purchasing those goods or services. As for infusions of capital, they would constitute aid when made by the state under conditions that are inconsistent with the normal practices of

[89] *Combatting corporate tax avoidance: Commission presents Tax Transparency Package,* n. 88 above.
[90] Defined as an entity engaged in economic activity (European Commission, Notice on the notion of state aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, 2016/C 262/1, para. 7).
[91] Ibid., para. 51.
[92] Ibid., para. 66.

private investors. Finally, waiving taxes or fines, quite obviously, confers and advantage every time it happens.

Additionally, in order to qualify as state aid, within the meaning of EU law, the transfer of resources must be made on a selective basis; that is, it must be targeted at a certain undertaking, group or category of undertakings, or a particular economic sector. Where a form of aid is generally available to all undertakings within the jurisdiction of a given Member State, and does not selectively favour any undertaking or economic sector, such aid falls outside the scope of the EU's system of state aid control. [93]

The cornerstone rule on EU state aid law is enshrined in Article 107(1) of the TFEU, which reads the following:

> Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

In other words, any form of state aid that selectively gives an advantage to its recipient – thus distorting competition on the market[94] – and affects trade between Member States[95] is, *in principle*, prohibited. However, certain categories of aid are exempted from the general prohibition, as government support may be necessary for furthering certain legitimate policy objectives and for addressing market failures. By way of derogation from Article 107(1), the second paragraph of Article 107 declares certain types of aid to be compatible with the internal

[93] Ibid, paras. 116 and 117.

[94] Generally, whenever the granted advantage improves the competitive position of the recipient, competition on the market is distorted. (ibid, para. 187)

[95] As it is sufficient to show that the aid may have a potential effect on trade between Member States, as opposed to an actual effect, this requirement is fairly easy to meet. For instance, an effect on cross-border trade may be found even where the recipient of aid does not engage in cross-border trade, given that the aid improves its competitive position in comparison to the suppliers of goods and services that are located in other Member States and are supplying, or may supply, the home market of the recipient. Moreover, even though the requirement that the aid affect trade between Member States is conceptually distinct from the requirement that competition be distorted, the two criteria are in practice "considered to be inextricably linked" and, are therefore, analyzed together. Hence, aid that selectively grants an advantage is likely to distort competition and affect trade between Member States. Nonetheless, it is possible for a measure, otherwise qualifying as state aid, to have a purely domestic effect, and to hence fall outside the scope of Article 107 TFEU. (ibid, para. 190, 191, 186, and 196)

market,[96] while the third paragraph lists several other categories that "may be considered to be compatible with the internal market".[97]

Generally, state aid is subject to a process of *ex ante* control carried out by the Commission. Where a Member State is considering providing some form of support to an undertaking or an economic sector it must first notify the planned aid to the Commission. Only after the Commission has approved the projected provision of aid as compatible with the internal market, may the Member State in question implement the measure.[98] There are nonetheless certain exceptions from the requirement to seek the Commission's approval before providing state aid. One such exception is the so-called *de minimis* aid; that is, small value aid not exceeding more than EUR 200,000 per undertaking over a period of three years (in the case of the road freight transport sector, the maximum amount is EUR 100,000).[99] Similarly, certain types of aid that have been predefined by way of a so-called *block exemption regulation* may be provided without the need to notify the Commission.[100] Quite obviously, the categories of aid that are exempt from notification are considered to be compatible with the internal market within the meaning of the second and third paragraphs of Article 107. Where a type of state aid is not exempt from the notification requirement, the Member State's failure to notify it renders the support measure unlawful. Should a Commission investigation lead to a finding that a Member State has provided unlawful aid that is incompatible

[96] "(a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned; (b) aid to make good the damage caused by natural disasters or exceptional occurrences; [and] (c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division."

[97] "(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349 [the EU's outermost regions: Guadeloupe, French Guiana, Martinique, Réunion, Saint-Barthélemy, Saint-Martin, the Azores, Madeira and the Canary Islands], in view of their structural, economic and social situation; (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State; (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest; (d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest; [and] (e) such other categories of aid as may be specified by decision of the Council on a proposal from the Commission."

[98] "The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. […] The Member State concerned shall not put its proposed measures into effect until [the Commission has given] a final decision." (Article 108(3) TFEU) See also the 'standstill clause' in Article 3 of Council Regulation 2015/1589 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union.

[99] Commission Regulation 1407/2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid.

[100] The exemptions are regulated by a general block exemption regulation (Commission Regulation 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty) as well as by several sectoral block exemption regulations (*e.g.,* Commission Regulation 702/2014 declaring certain categories of aid in the agricultural and forestry sectors and in rural areas compatible with the internal market in application of Articles 107 and 108 of the Treaty on the Functioning of the European Union).

with the internal market, the former may order the latter to recover the aid from the beneficiary undertaking.[101]

As mentioned, state aid may come in the form of tax measures. Where a fiscal measure reduces the tax burden of an undertaking (or a category of undertakings, or an economic sector,) in a selective manner – i.e., without making the same advantage generally available to all taxpayers within the state's jurisdiction that are in similar factual and legal circumstance – the measure is likely to qualify as state aid. By way of example, the following types of tax measures may constitute state aid: "a reduction in the tax base (such as special deductions, special or accelerated depreciation arrangements or the entering of reserves on the balance sheet)"; "a total or partial reduction in the amount of tax (such as exemption or a tax credit)"; or, the "deferment, cancellation or even special rescheduling of tax debt".[102] The measure may take the form of legal provisions in a law or a regulation, or it may be a decision of a tax authority, such as a tax ruling (see p. 29 above). What really matters, for purposes of state aid law, is whether the measure favours certain taxpayers in a discriminatory manner, in derogation from the generally applicable rules on taxation in that jurisdiction.[103] It is perhaps worth noting that some of the harmful tax measures covered by the Code of Conduct on Business taxation may constitute state aid, as acknowledged by the Code itself.[104]

A particular concern of the Directorate General for Competition (DG Competition) – which is the Commission's department responsible for enforcing state aid law – is fiscal aid in the form of tax rulings. In the summer of 2013, DG Competition established a *task force on tax planning practices* in order to investigate public allegations that certain companies were benefitting from fiscal aid granted by means of tax rulings.[105] After an initial inquiry into the tax rulings practice of several Member States (Cyprus, Ireland, Luxembourg, Malta, the Netherlands, and the UK), DG Competition extended the probe, in December 2014, to cover all Member States.[106] Thus, Member States were asked to provide the Commission with information on the tax rulings issued by their tax authorities between 2010 and 2013. In total, DG Competition analyzed more than 1000 tax rulings rendered by

[101] "If, after giving notice to the parties concerned to submit their comments, the Commission finds that aid granted by a State or through State resources is not compatible with the internal market having regard to Article 107, or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission." (Article 108(2) TFEU) See also Council Regulation 2015/1589, n. 100 above, Article 16.

[102] Commission notice on the application of the State aid rules to measures relating to direct business taxation (98/C 384/03), para. 9.

[103] Ibid, para. 16.

[104] Code of Conduct for Business Taxation, n. 55 above, para. J.

[105] DG Competition website, http://ec.europa.eu/competition/state_aid/tax_rulings/index_en.html.

[106] European Commission, *State Aid: Commission extends information enquiry on tax ruling practices to all Member States*, press release, 17 December 2014, http://europa.eu/rapid/press-release_IP-14-2742_en.htm.

the authorities of Member States, including 600 rulings mentioned in the infamous *LuxLeaks*.[107] Following the inquiry – which had focused particularly on rulings approving transfer pricing arrangements[108] – the Commission opened formal investigations, in 2014 and 2015, with respect to tax rulings granted by Ireland to Apple, Luxembourg to Fiat, Amazon and McDonald's, the Netherlands to Starbucks, and by Belgium in the context of its so-called 'excess profit scheme'.[109] More recently, in September 2016, DG Competition opened another investigation related to tax rulings given by Luxembourg, this time in favour of GDF Suez.[110] Four of these investigations were concluded in 2015 and 2016, resulting in so-called 'negative decisions with recovery'[111] – that is, a decision finding that illegal aid was given, and ordering the Member State at issue to recover the aid. The recoverable amount in the case of fiscal state aid equals the difference between the tax actually paid by the aid beneficiary and the value of what it should have normally paid absent the preferential treatment, to which interest is added.[112] The first two negative decisions were both issued on 21 October 2015 and concerned the tax preferences given to Starbucks by the Netherlands and to Fiat by Luxembourg. In both cases, DG Competition determined that each of the two companies had received fiscal state aid valued in the range of EUR 20 to 30 million (the exact amount was left to be subsequently determined).[113] The two other decisions came out in 2016. The first one concerned Belgium's excess profit scheme and the second one related to Ireland's aid to Apple. In the investigation concerning the Belgian scheme, the Commission found that 35 multinational companies had received fiscal state aid totalling an estimated EUR 700 million.[114] As for the Apple case, the Commission concluded that Ireland had given the American company fiscal aid worth of a staggering EUR 13 billion.[115] As already mentioned, the aid must be recovered in all the four cases. The other

[107] European Commission, DG Competition, *Working Paper on State Aid and Tax Rulings*, 2016, paras. 5 and 6, and n. 8.

[108] Tax rulings endorsing intra-corporate transfer prices that manifestly deviate from what those prices would be if the relevant transactions were at 'arm's length' – that is, if they don't reliably approximate a market outcome – may constitute state aid. (Commission notice on the notion of state aid, n. 91 above, paras. 171 and 172)

[109], *Working Paper on State Aid and Tax Rulings*, n. 108 above, paras. 7 and 8.

[110] European Commission, *State Aid: Commission opens in-depth investigation into Luxembourg tax treatment of GDF Suez (now Engie)*, press release, 19 September 2016, http://europa.eu/rapid/press-release_IP-16-3085_en.htm (accessed 24 August 2016).

[111] *Working Paper on State Aid and Tax Rulings*, , n. 108 above, para. 8. See also DG Competition website, n. 106 above.

[112] Commission notice on the application of the State aid rules to measures relating to direct business taxation, (98/C 384/03), para. 35.

[113] European Commission, *Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules,* press release, 21 October 2015, http://europa.eu/rapid/press-release_IP-15-5880_en.htm.

[114] European Commission, *State aid: Commission concludes Belgian "Excess Profit" tax scheme illegal; around €700 million to be recovered from 35 multinational companies*, press release, 11 January 2016, http://europa.eu/rapid/press-release_IP-16-42_en.htm.

[115] European Commission, *State aid: Ireland gave illegal tax benefits to Apple worth up to €13 billion*, press release, 30 August 2016, http://europa.eu/rapid/press-release_IP-16-2923_en.htm.

three cases regarding Luxembourg's treatment of Amazon, McDonald's and GDF Suez are still pending.[116]

Alongside the Code of Conduct for Business Taxation, the CCCTB, the Anti-Tax Avoidance Directive and the mandatory exchanges of information on tax ruling, the enforcement of state aid law in the field of taxation, particularly with regard to tax rulings, contributes to the goal of the FIRES recommendation to end "blatant institutional arbitrage and sweetheart deals negotiated between national governments and large multinational corporations" (see p. 24 above). Not only there is no tension between the FIRES recommendations on corporate taxation and existing EU law and policy on the matter, but quite the contrary, the former seems to be perfectly in line with the latter. Given that the EU is already pursuing policies of the type advocated for by the FIRES experts, and considering the number of EU initiative in this area, including legislative measures and proposals, as well as the fact that the enforcement of state aid law against fiscal aid is an EU exclusive competence, we are of the view that the recommendations on corporate tax should primarily be addressed to the EU level of governance. In fact, the FIRES recommendations on corporate taxation relate to a problem that can only be adequately addressed at EU level.

4.2.2 Taxation of dividends and capital gains

Returns "on entrepreneurship largely accrue[ ] in the form of dividends and capital gains from ownership stakes in the firm".[117] "A high tax rate on dividends encourages a reliance on retained earnings to finance expansion. Such a tax rate punishes new ventures, locks in retained earnings, and traps capital in incumbent firms. Therefore, a high tax rate on dividends obstructs the flow of capital to the most promising projects because it favours incumbent ventures […]. Most of the economic return from successful high-impact entrepreneurial firms accrues to owners in the form of a dramatically increased value of their shares rather than as dividends or large interest payments to the owners. Thus, the taxation of capital gains on stock holdings greatly affects the incentives of potential high-impact entrepreneurs and their (equity) financiers […]."[118]

Recommendations

[116] DG Competition website, n. 106 above.

[117] Elert et al.,n. 2 above, p. 33.

[118] Ibid., p.28.

Complexities such as large variations of the level of the tax rate, depending on the circumstances of the tax payer should be removed, where possible. "Instead, countries should aim for dividend and capital gains tax rates with few exceptions and few (opaque) concessionary schemes."[119]

We have not identified any obstacle to implement this recommendation in either EU law or policy, aside from the constraints imposed by the division of competence on tax matters between the EU and Member States, as explained in section 4.1 above. Regarding a possible legal basis for the EU to take action in order to implement this recommendation, Article 115 of the TFEU seems to be the obvious candidate, given that all EU legislation touching upon direct taxation so far relied on this treaty provision. However, it must be borne in mind that the limited competence given by Article 115 TFEU to the EU over direct taxation matters, coupled with the political sensitivity of regulating levels of taxation in Member States, may very likely not allow for the harmonization of tax rates on dividends and capital gains. Therefore, this recommendation should primarily be addressed to the Member States.

It is worth mentioning, despite being of limited relevance in the context of the above recommendation, that the EU has already in place legislation addressing the taxation of dividends and other profit distributions paid to a parent company sitting in one Member State by its subsidiary located in a different Member State. The objective of the 'parent-subsidiary' directive (2011/96), the first edition of which was adopted in 1990,[120] "is to exempt dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and to eliminate double taxation of such income at the level of the parent company".[121] Moreover, the directive seeks to ensure that dividend payments between a parent and a subsidiary located in different Member States are not subject to less favourable treatment than that given to payments between a subsidiary and parent company sitting in the same Member State.[122] The main provisions of Directive 2011/96 require Member States to either refrain from taxing the dividends received by a parent company located in its jurisdiction, to the extent that the payments are not deductible by the subsidiary, or, in the alternative, to allow the parent company to deduct from its tax base the tax paid by its subsidiary in connection to the dividends in its host Member State. An important clarification is that where the payments are deductible by the subsidiary, Member States *must* tax the parent company in order to

[119] Ibid., 34.

[120] Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

[121] Council Directive 2011/96 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, 3rd recital of the preamble.

[122] Ibid, 9th recital of the preamble.

avoid double non-taxation (Article 4(1)). Additionally, Member States are required to exempt the cross-border payment on dividends from withholding taxes (Articles 5 and 6).

A final observation is that the Member States' law on the taxation of dividends must not discriminate between domestic payments and payments received from, or made towards, other Member States. For instance, a tax regime discriminating against dividend payments received from other Member States may dissuade residents of the Member State in question from investing in another Member State and may hinder the ability of companies located in other Member States to raise capital in that Member State. To the extent that a Member State's tax rules applicable to payments of dividends distort intra-EU investments, the rules at issue may be in contravention of Article 63 of TFEU, providing for the free movement of capital between Member States and between Member States and third countries.[123]

4.2.3 Taxation of labor income

Levels of labor taxation influence occupational choice, incentives for work effort, the willingness to acquire new skills, career aspirations and the supply of labor.[124] "[H]igh and progressive labor taxes lower the rate of return on highly productive skills" and is likely to "impair the supply of skilled labor" which is needed to enable innovative and high growth entrepreneurship. [125]

Recommendations

"[H]igh labor taxation has less detrimental effects if access to valuable subsidies in cash or in-kind (e.g., child care and pension rights) is tied to employment and if each spouse's income is taxed separately rather than jointly […]. Reform is therefore needed to combine lower labor taxes with a stricter coupling of subsidies, such as child care and pension rights, to employment."[126]

As explained above, the harmonization, at EU level, of rates for direct taxation is likely to prove impossible, given the limited competence conferred by the Treaties to the EU in this regard, but also due to the Member States' likely reluctance to constrain their fiscal sovereignty to such an extent. Hence, in so far as the elements of the recommendation concerning the level of labor taxation are concerned, the recommendation should primarily be addressed to Member States. The same applies when it comes to social policy. As social policy mainly remains within the responsibility of Member States, the remaining part of the recommendation should also be chiefly directed towards the

[123] Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, *Dividend Taxation of Individuals in the Internal Market,* COM(2003)810final, 19 December 2003, pp. 9-13 in particular.

[124] Elert et al., n. 2 above, p. 29.

[125] Ibid.

[126] Ibid., pp. 30-32.

national governments. Nonetheless, the treaties do bestow upon the Union certain competences related to social policy. Thus, paragraphs (2) and (3) of Article 5 of the TFEU mandates the Union to "take measures to ensure coordination of the employment policies of the Member States" (by way of guidelines, in particular) and authorizes "initiatives to ensure coordination of Member States' social policies". More importantly, according to Article 4(2)(b) of the TFEU, the Union enjoys a shared competence with respect to social policy, as far as the aspects of social policy defined in the Treaty are concerned.[127] Unfortunately, it is not entirely clear which aspects of social policy fall within the EU's shared competences and which are covered by Article 5.[128] Normally, EU policies touching upon social policy are concerned with situations that have a cross-border element – *e.g.,* the portability, or exportability, of social benefits where an EU national moves from one Member State to another. As national social security systems are not harmonized, EU law regulates the interactions between them in order to create the conditions necessary to ensure the free movement of people within the EU.[129]

4.2.4 Taxation of stock options

Stock options can be used to incentivize workers, and may prove to be a good substitute for high wages in the early life of the firm.[130] There are indications that they are widely used if that is "advantageous from a tax perspective"[131]. However, the incentive effect is diminished if stock options are subject to the same tax levels as wage income and if the tax liability cannot be deferred until the stocks are sold.[132] Furthermore, "[t]he low effective taxation of gains on employee stock options appears to be necessary" for the development of a solid venture capital (VC) sector.[133] Countries with very high levels of taxation of stock options tend to have an extremely small VC sector, whereas the opposite is true for countries with high levels of taxation. It seems that "the effective tax treatment of option contracts may in itself be a major determinant to the size of the VC-funded entrepreneurial sector."[134]

Recommendations

[127] More detailed provisions on the EU's competence on social policy can be found in Title X of TFEU and in other provisions of the treaty. For instance, Article 21, establishing the right of EU citizens to reside and move freely throughout the EU, grants the Union the power to adopt measures concerning social security and social protection for purposes of enabling the exercise of the aforementioned right. Similarly, Article 48 of TFEU gives the EU the competence to adopt measures in the field of social security in order to enable the free movement of workers.

[128] Craig and de Búrca, n. 10 above, p. 88.

[129] See, for instance, Regulation 883/2004 of the European Parliament and of the Council on the coordination of the social security systems.

[130] Elert et al., n. 2 above, p. 28.

[131] Ibid., p. 34.

[132] Ibid., p. 28.

[133] Ibid., p. 29.

[134] Ibid., p. 34.

“Lowered taxation of gains on employee stock options in the startup sector is likely to be necessary in many countries, both to lure talented people away from traditional careers in incumbent firms and to channel institutional capital into the entrepreneurial sector, which should be mediated by a professional VC sector. This policy would narrowly target the entrepreneurial sector rather than entail broad tax cuts […] if designed to apply only to startups receiving VC-funding, a small but strategic sector of the economy. The policy lowers the effective taxation of startups that are screened by venture capitalists willing to invest their own funds without requiring the government to determine which firms are entrepreneurial. Innovative startups can then be favoured without needing broad capital gains tax cuts.[fn] A tax break that targets human capital in this segment would promote innovative entrepreneurship without the high fiscal cost of broad capital gains tax cuts. Moreover, broad-based capital gains tax cuts do not shift capital from passive investments to private equity, unlike tax breaks on stock options and other instruments used by the VC sector.”[135]

As this recommendation seems to require the regulation of the tax rates applicable to gains on stock options, and bearing in mind that the EU enjoys only limited competence in regulating levels for direct taxation while at the same time facing severe political constraints in this regard, this recommendation should primarily be addressed to Member States.

4.3. Summary and conclusions

As shown above, the EU does not enjoy any explicit competence with respect to direct taxation – as opposed to indirect taxation. That being the case, the competence to regulate direct taxation, and tax rates in particular, rests with the Member States. Nonetheless, the EU may enact legislation touching on direct taxation on the basis the broad powers conferred upon it by Article 115 TFEU, which allows it to harmonize national laws directly affecting the establishment and functioning of the internal market. To be borne in mind is that the use of Article 115 is subject to the demanding requirement of securing unanimity in the Council on the adoption of the proposed measure. So far, Article 115 has been used as a legal basis for a number of legislative acts addressing harmful tax competition and tax avoidance. In addition, to Article 115, the flexibility clause enshrined in Article 352 TFEU may also serve as a legal basis for EU legislation in the area of taxation. Like Article 115, Article 352 requires unanimity in the Council. Furthermore, action against harmful tax competition may be also taken by the Commission to the extent that a particular tax measure imputable to a Member State constitutes states aid.

[135] Ibid., p. 35.

Legislative action aside, the EU may also issue recommendations to Member State with respect to their tax policies, including in the context of the yearly exercise of coordinating the Member States' economic policies known as the European Semester. Finally, another soft law mechanism that may be used for coordinating national policies is the Open Method of Coordination. An example of a process pertaining to the OMC that was established with the purpose of facilitating the coordination of certain national tax policies is the Code of Conduct for Business Taxation.

That being said, the FIRES recommendations on taxation policy should generally be addressed to both Member States and the EU. However, those recommendations that concern tax rates or have elements pertaining to social policies, such as the recommendations on the taxation of labor income, should primarily be addressed to Member States. Finally, the recommendations on corporate taxation should primarily be addressed to the EU institutions, given the EU is already pursuing in this area policies of the type advocated by the FIRES experts.

5. Regulations governing savings, capital and finance

Access to the appropriate kind of capital is a prerequisite for a thriving entrepreneurial environment. More specifically, the success of start-ups is often contingent on access to equity financing. This is particularly true for high-growth firms, which tend to require significant infusions of external equity capital. Given the high-level of business risk that characterizes newly-established firms, start-ups find it difficult to secure the requisite financing from large financial institutions. The reason for that is that such institutions are often not in the position to assess the viability and profitability of new firms. Hence, a healthy entrepreneurial environment requires a developed venture capital sector and informal investors, such as business angels. Such forms of raising capital are to be preferred to other forms of financing, for instance bank financing, as the former provides entrepreneurs not only with funds, but also with expertise and access to networks and business contacts. The highly developed financial sector in the US is considered to be an important factor contributing to the success of its entrepreneurial economy.[136]

Recommendations

Reform is needed "to support increased private wealth formation and the creation of a dynamic venture capital industry, as these are crucial sources of financing, particularly in the early stages of entrepreneurial projects. As a large share of savings in the economy currently goes into pension

[136] Elert et al., n. 2 above, pp. 35 – 38.

funds, it would be helpful to allow at least part of these assets to be invested in entrepreneurial firms and not just in real estate, public stock and bonds”.[137]

“As a long-term solution, the best way to ensure the financing of entrepreneurial firms is likely to be the pursuit of policies that encourage private wealth accumulation in forms that do not preclude the assets from being used as equity in entrepreneurial ventures.”[138]

“Since large financial institutions can rarely invest directly in small and new firms, a bridging intermediating role must be provided by a professional VC [venture capital] sector […] Here, policymakers could be inspired by the U.S. experience of the 1970s and 1980s, and adopt a broad-based policy approach: an encouraging legal framework that combines tax cuts in capital gains with legislation allowing pension funds to invest in high-risk securities issued by small and new firms as well as VC funds.[fn] Additionally, […] effective tax treatments of options contracts are necessary to enable VC firms and other actors in the entrepreneurial ecosystem to design the appropriate incentive contracts for founders and other key personnel needed to build innovative firms.[fn]”[139]

To the extent that the implementation of the above recommendations requires tax measures, the analysis and conclusions laid down in the previous chapter on tax policy also applies to this chapter *mutatis mutandis.* In any case, the most important aspect to bear in mind is that the rates for direct taxes are set at national level. As it seems that measures aimed at encouraging wealth accumulation are likely to involve the regulation of taxation levels – *e.g.* reductions of the level of taxes on capital gains, the recommendations should primarily be addressed to Member States. Given that social security systems fall within the scope of the exclusive competences of the Member States, the recommendation to allow pension funds to invest in securities issued by small firms, and in venture capital funds, should also primarily be directed at the national level of governance. Nonetheless, as mentioned above, Article 5(3) of the TFEU permits the Union to “take initiatives to ensure coordination of Member States’ social policies”. Moreover, to the extent that the regulations concerning the investments of pensions funds constitute unjustifiable restrictions on the intra-EU movement of capital, the Commission may take action and order the Member State(s) in question to remove the restrictions. Finally, the EU may use soft law instruments, such as recommendations and the open method of coordination, for purposes of nudging the Member States to implement the policies recommended in the context of the FIRES project.

[137] Ibid., pp. 4 and 83.
[138] Ibid., p. 38.
[139] Ibid., pp. 39 – 41.

That being said, the EU has already taken initiatives aimed at fostering the development of the European venture capital market. In its Europe 2020 strategy, the European Commission stated its objective of "[m]aking an efficient European venture capital market a reality, thereby greatly facilitating direct business access to capital markets and exploring incentives for private sector funds that make financing available for start-up companies, and for innovative SMEs".[140] In a subsequent policy document – the so-called 'Single Market Act' – the Commission acknowledged that venture capital markets were not sufficiently developed in the EU and that "[f]acilitating access to funding for rapidly expanding SMEs is a requirement of utmost importance".[141] In the same document, the Commission called for legislation that would better enable venture capital funds to invest in other Member States. As a consequence, SMEs would have more opportunity to raise capital.[142]

In line with the objective of facilitating the development of venture capital markets, the Commission made a proposal, at the end of 2011, for a regulation on European venture capital funds,[143] which was eventually adopted in April 2013 as Regulation 345/2013.[144] The regulation established uniform rules that are aimed at enabling certain qualifying venture capital funds to "market their funds and raise capital on a pan-European basis across the Single Market".[145] The fund managers who comply with the requisite conditions, among which to invest predominantly in unlisted SMEs, may use the label 'EuVECA' (European Venture Capital Fund). Access to the EuVECA designation is contingent upon complying with certain requirements – *e.g.*, concerning the funds' relationship to investors – which are meant to "ensure the confidence of investors that wish to invest in venture capital funds".[146] The expectation was that the Regulation would contribute to the expansion of the European venture capital funds[147] which were, on average, only half the size of the average American venture capital fund.[148]

[140] Communication from the Commission, *Europe 2020: A strategy for smart, sustainable and inclusive growth*, COM(2010)2020, 3 March 2010, p. 20.
[141] Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions, *Single Market Act: Twelve levers to boost growth and strengthen confidence – "Working together to create new growth"*, COM(2011)206final, 13 April 2011, pp. 6 and 7.
[142] Ibid., p. 6.
[143] European Commission, Proposal for a Regulation of the European Parliament and of the Council on European Venture Capital Funds, COM(2011)860final, 7 December 2011.
[144] Regulation 354/2013 of the European Parliament and of the Council on European venture capital funds.
[145] Communication from the Commission to the Council, to the European Parliament, to the Committee of the Regions, and to the European and Social Committee, *An action plan to improve access to finance for SMEs*, COM(2011)870final, 7 December 2011, p. 3.
[146] Recital 3 of Regulation 354/2003 on European venture capital funds.
[147] *An action plan to improve access to finance for SMEs,* n. 146 above, p. 3.
[148] Proposal for a Regulation, n. 144 above, Explanatory Memorandum, p. 1.

Another noteworthy EU initiative targeted at improving access to venture capital is the 'Pan-European Venture Capital Fund-of-Funds'.[149] Under this program, the European Investment Fund (EIF) intends to invest, alongside private investors, in one or more so-called 'Venture Capital Funds-of-Funds'. The EIF is prepared to invest up to €300 million per fund-of-funds but not more than 25% of the fund's total commitments. Once operational, the Fund(s)-Of-funds would invest in qualifying venture capital funds.[150] The stated objective of this initiative is "to address Europe's equity gap, the fragmentation of the VC market and to attract additional private funding from institutional investors into the EU venture capital asset class".[151] A similar, though more modest initiative is the 'InnovFin Fund-of-funds', under which the EIF may invest up to €50 million in funds-of-funds targeting financial intermediaries that provide early stage venture capital.[152] Finally, under the 'Equity Facility for Growth' scheme, the EIF may also invest up to €30 million in venture capital funds committed to invest in SMEs at the growth and expansion stage.[153]

6. The organization of labor markets and social security

The costs of complying with onerous requirements imposed by labor and social security laws have a high impact on entrepreneurial firms, which tend to be young, small, and less-capital intensive. Strict standards governing the dismissal of employees, including the requirement to pay severance, where applicable, hinders the ability of small firms to make adequate adjustments to their workforce, such as the ones imposed by market fluctuations. As a result of such inflexibilities, the risk profile of entrepreneurial firms increases.[154] Moreover, research has shown that that the entrepreneurial culture is more developed in countries where "hiring and dismissing employees is relatively easy and inexpensive".[155] Europe's lag behind the US in entrepreneurship may partially be explained by the stricter labor regulations prevailing in European countries. Although policy makers in certain

[149] A fund that invests in other funds.

[150] European Investment Fund website, http://www.eif.org/what_we_do/equity/paneuropean_venture_capital_fund_of_funds/index.htm. See also Call for expression of interest to select Pan-European Fund-of-Fund Promoter(s) under the Pan-European VC Fund-of-Funds Programme, 8 November 2016, http://www.eif.org/what_we_do/equity/paneuropean_venture_capital_fund_of_funds/call/Pan-European%20VC%20FoF%20Programme_Call%20for%20Expression%20of%20Interest.pdf.

[151] European Investment Fund, *The Pan-European VC Fund(s)-of-Funds Programme – Frequently Asked Questions,* 21 December 2016, response to question 1 at p. 4, http://www.eif.org/what_we_do/equity/paneuropean_venture_capital_fund_of_funds/frequently_asked_questions_pan_european_vc_fof_programme.pdf.

[152] European Investment Fund, *InnovFin Fund of Funds*, November 2016, http://www.eif.org/news_centre/publications/innovfin-equity-leaflets/innovfin_funds_of_funds.pdf.

[153] European Investment Funds, *COSME financial instruments*, http://www.eif.org/news_centre/publications/eif_flyer_cosme_en.pdf.

[154] Elert et al., n. 2 above, pp. 43 and 44.

[155] Ibid., p. 44

European countries are aware of the fact that the costs imposed on small firms by stringent labor laws may be overburdensome, relieving the firms that are smaller than a certain threshold of some of the labor law obligations is also a sub-optimal policy. Research in Germany has shown that firms deliberately stay small in order to avoid the higher costs imposed on them by labor laws once they exceed the size threshold. In a sense, it can be said that such a policy is the equivalent of a tax on growth.[156]

Additionally, there is a positive correlation between employment protection and social security, on one hand, and the opportunity cost of becoming an entrepreneur, on the another. The more benefits afforded to an employee, the less likely it is that she will leave her secure job and take up entrepreneurship or a risky job in a start-up. Hence, the incentive to become an entrepreneur is diminished.[157]

Recommendations

"Given the large worker flows required in a dynamic entrepreneurial ecosystem, institutions should facilitate the recruitment of workers with the necessary competencies. […] Importantly, this requires the removal of onerous employment protection legislation, as this discourages potential high-growth firms from expanding.[158] "If the goal is to make the European Union more inclusive, innovative and entrepreneurial, it is highly advisable that the most regulated countries reduce the stringency of their EPL [employment protection legislation] for permanent contracts. A competently implemented liberalization will reduce job security but increase employment security for workers, as labor demand will increase and more opportunities will be created in the labor market. For liberalization to have the desired results, countries must develop their own strategies to avoid jeopardizing the process, ideally by considering and possibly emulating the paths already taken by similar countries. This also presupposes the implementation of complementary social insurance institutions."[159]

"Social security institutions should enable the portability of tenure rights and pension plans as well as a full decoupling of health insurance from the current employer, to avoid punishing those individuals who leave tenured employment positions to pursue entrepreneurial projects".[160]

[156] Ibid., pp. 44 – 46.
[157] Ibid., pp. 44, 45 and 49.
[158] Ibid., p. 51.
[159] Ibid., p. 48.
[160] Ibid., p. 4.

"Making parts of social insurance benefits 'portable' […] between jobs and between regular employment and self-employment would mitigate" the opportunity cost of becoming an entrepreneur.[161] "In addition, supplementary pension plans should be made fully actuarial and portable. Making social security more portable and tied to the individual would also improve the low geographical mobility of workers in Europe, since being tied to a job in a firm also implies being tied to a specific location. […] While the specifics can and will vary, we can infer that an important component of a policy that makes society more innovative and entrepreneurial involves making the individual's social insurances as portable as possible when changing jobs and moving between salaried employment and self-employment. This should be the case regardless of whether the insurance is public, paid by the individual herself, or paid by the employer based on individual or collective (union) agreement." [162]

Employment policy

Article 2(3) of the TFEU mandates Member States to "coordinate their economic and employment policies within arrangements as determined by [the TFEU], which the Union shall have competence to provide". In its turn, "[t]he Union shall take measures to ensure coordination of the employment policies of the Member States, *in particular by defining guidelines for these policies*" (Article 5(2) TFEU; emphasis added). More detailed provisions concerning the EU's competences on employment policies may be found in Title IX of the TFEU, titled 'Employment'. The opening article of Title X requires the EU and the Member States to "work towards developing a coordinated strategy for employment and particularly for promoting a skilled, trained and adaptable workforce and labour markets responsive to economic change with a view to achieving the objectives defined in Article 3 of the Treaty on European Union" (Article 145). Article 3 TEU sets down the general objectives of the Union, among which, "to work for the sustainable development of Europe based on […][*inter alia*] a highly competitive social market economy, aiming at full employment".

Moving beyond general objectives, the scope of the EU's powers with respect to employment policy is circumscribed by Articles 147 through 149 of Title IX of the TFEU. Article 147 clarifies that the EU is to "contribute to a high level of employment by *encouraging cooperation* between Member States and by *supporting* and if necessary *complementing* their action" (emphasis added). The language of this clause, together with the afore-cited Articles 2(3) and 5(2) of the TFEU, suggests that EU initiatives regarding employment policy are limited to soft law approaches. This is reinforced by the

[161] Ibid., p. 45.
[162] Ibid., p. 50.

provisions of Articles 148 and 149. The former instructs the Council to prepare guidelines each year on the basis of the European Council's conclusions on the situation of employment in the EU. The Member States, in turn, must take into account the Council's guidelines when devising their employment policies and submit an annual report to the Commission and Council setting out the principal measures they took in order to implement the guidelines. On the basis of the Member States' reports, the Council is required to assess their implementation of its guidelines. Following its assessment, the Council may issue further recommendations to Member States, if appropriate. It is noteworthy that Article 148 TFEU is primarily implemented in the context of the European Semester (see p. 22 above). In fact, the promotion of employment is one of the central policy areas of concern for the European Semester. Below is an example of a country-specific recommendation on employment policy that was made on the basis of Article 148(4) TFEU in the context of the Semester. The country concerned is Portugal.

> Promote hiring on open-ended contracts, including by reviewing the legal framework. Ensure the effective activation of the long-term unemployed. Together with social partners, ensure that minimum wage developments do not harm employment of the low-skilled.[163]

As for Article 149, it gives the EU the option of adopting incentive measures, in the form of legislation, "designed to *encourage cooperation* between Member States and to *support their action* in the field of employment through initiatives aimed at developing *exchanges of information and best practices*, *providing comparative analysis and advice* as well as *promoting innovative approaches and evaluating experiences*, in particular by recourse to pilot projects" (emphasis added). If it were not already clear enough, the last sentence of Article 149 spells out that such legislation "shall not include harmonization of the laws and regulations of Member States". An example of an act adopted on the basis of what is now Article 149 is Decision 1672/2006 of the Parliament and the Council establishing a 'Community Programme for Employment and Solidarity' – known as 'Progress'. Under this program, the EU provided funding – hence the term incentive measure – to public and private actors (e.g. public bodies within Member States, NGOs, etc), for conducting activities relevant to employment and solidarity, such as, collecting data and statistics, conducting studies, or organizing conferences and exchanges of best practices.

In addition to Title IX, Title X of the TFEU, concerning social policy, also contains provisions related to employment policy. Despite the formal separation of the provisions on employment and social policy into two discrete sections of the treaty, it is difficult to disentangle the aspects pertaining to the

[163] Council Recommendation of 11 July 2017 on the 2017 National Reform Programme of Portugal and delivering a Council opinion on the 2017 Stability Programme of Portugal, 2017/C 261/21.

former from the ones related to the latter. This is illustrated by Article 151, the opening clause of Title X, which lists a number of objectives of the Union and the Member States regarding social policy. Some of those objectives clearly concern employment policy and labor laws. For instance, Article 151 mentions the promotion of employment, improved working conditions and the dialogue between management and labor. Moreover, Article 156, of Title X, charges the Commission with encouraging the cooperation and facilitating the coordination of Member States in matters related, among other things, to employment, labor law, working conditions, and the right to association and collective bargaining between employers and workers. The Commission is to discharge its duties in this regard by: making studies; delivering opinions; arranging consultations; establishing guidelines and indicators; organizing exchanges of best practices; and conducting periodic monitoring and evaluation. This seems perfectly in line with the soft law processes envisioned by the provisions of Title IX. Like the instruments contemplated by the provisions of Title X, the ones mentioned by Article 156 are of the type specific to the Open Method of Coordination. Nonetheless, Article 153(2)(b) of Title X, also contemplates the harmonization of national laws by way of establishing minimum requirements through EU binding legislation. Among the matters subject to this provision are: the improvement of the working environment to protect the workers' health and safety; working conditions; social security and social protection of workers; the protection of workers where their employment contract is terminated; the information and consultation of workers; and the representation and collective defense of workers and employers.[164] Given that Article 153(2)(b) may only be relied on to establish minimum requirements, it rather obviously cannot be used for implementing the FIRES recommendations to reduce the stringency of labor laws in connection to permanent contracts.

Apart from the provisions of Titles IX and X of the TFEU, the Council may also rely on Article 292 for issuing recommendations to Member States. Recall that Article 292 gives the Council a general power to adopt recommendations (see p. 21 above). One example of such a recommendation relating to employment policy is the Council Recommendation establishing a Youth Guarantee.[165] By way of this recommendation the Member States are advised to adopt measures aimed at improving youth employment, such as reducing the non-wage labor costs borne by firms employing young people and providing wage and recruitment subsidies.

[164] It is to be noted that paragraph (5) of Article 153 carves out from the scope of application of Article 153 "pay, the right of association, the right to strike and the right to impose lock-outs". Hence, these matters are subject to neither coordination measures - at least not on the basis of Article 153 - nor to harmonization.
[165] Adopted on 22 April 2013.

The European Commission is well aware of the fact that “unbalanced or excessively rigid employment protection legislation [for permanent contracts] may be associated to undesirable labour market outcomes” such as labor market segmentation and low labor market dynamism.[166] As explained by the Commission, high dismissal costs for permanent employees induce employers to prefer the use of temporary contracts.[167] To resolve the problem, it suggested that the gap between the protection given to employees on permanent contracts and that conferred on those working under temporary contracts be reduced.[168] The Commission further advised that “increased contractual flexibility should go along with reforms providing universal and adequate coverage of unemployment benefits”.[169] Although not necessarily geared towards helping entrepreneurial firms but rather aiming at increasing labor market flexibility generally, these recommendations seem to be perfectly in line with the FIRES recommendations to reduce the stringency of employment protection legislation for permanent contracts. The objective of maintaining labor markets flexible was also mentioned in Commission Recommendation 2016/761 on the European Pillar of Social Rights, where the Commission recommended that “[i]n accordance with legislation and collective agreements, the necessary flexibility for employers to adapt swiftly to changes in the economic context shall be ensured” (recommendation 5(b)). Furthermore, the Council endorsed, back in 2007, a set of common principles on ‘flexicurity’. The concept describes employment policies aimed at increasing the flexibility of labor markets – which necessarily requires that labor laws do not unduly restrict an employer’s ability to dismiss employees, while at the same the same time enhancing the security of employees. As stated in the principles, “[f]lexicurity involves the deliberate combination of flexible and reliable contractual arrangements, comprehensive lifelong learning strategies, effective active labour market policies, and modern, adequate and sustainable social protection systems”.[170] In addition, the principles cautioned that “[s]ufficient contractual flexibility must be accompanied by secured transitions from job to job”.[171] The principles, which have no binding force, were prepared

[166] European Commission, *European Semester Factsheet: Employment Protection Legislation*, 2016, pp. 2 and 3. Labor market segmentation refers to a situation where the employees under a temporary contract find it difficult to transition to permanent contract (ibid, p. 3). Low market dynamism means low labor turnover (ibid, p. 4). https://ec.europa.eu/info/sites/info/files/european-semester_thematic-factsheet_employment-protection-legislation_en_0.pdf.

[167] Ibid, p. 6.

[168] Ibid, p. 7.

[169] Ibid, pp. 7 and 8.

[170] Council Conclusions of EPSCO Council, 6 December 2007, *Annex: The Common Principles on Flexicurity.*

[171] Ibid.

by the Commission in order to assist the Member States in devising and implementing flexicurity policies. [172]

The main conclusion that may be derived from the analysis of the provisions cited above is that, aside from Article 153(2)(b),[173] the TFEU only contemplates soft law instruments for purposes of ensuring the coordination and cooperation between the Member States with respect to their employment policies, and for complementing their actions, if necessary. Therefore, the FIRES recommendation concerning labor laws may only be implemented at EU level by means of such soft law instruments. As most of the competence to regulate labor markets is retained at national level, the recommendations should primarily be addressed to Member States.

Although it is unlikely that this would meaningfully constrain the implementation of the recommendation to reduce the stringency of employment protection legislation for permanent contracts, it is worth mentioning that there is European and international law in force setting minimum standards of protection against the dismissal of employees. At the international level, there is a 'Convention concerning the Termination of Employment at the Employer's Initiative' (No. 158), adopted in 1982 under the aegis of the International Labor Organization (ILO). However, only 10 EU Member States have to date ratified the convention.[174] At EU level, Article 30 of the Charter of Fundamental Rights states that "[e]very worker has the right to protection against unjustified dismissal, in accordance with Community". As for secondary legislation, Council Directive 98/59 on the approximation of the laws of the Member States relating to collective redundancies is potentially relevant. Aside from such binding legislation, Commission Recommendation 2016/761 on the European Pillar of Social Rights features the following recommendation concerning the dismissal of workers:

> Prior to any dismissal, workers have the right to be informed of the reasons and be granted a reasonable period of notice. They have the right to access to effective and impartial dispute resolution and, in case of unjustified dismissal, a right to redress, including adequate compensation.[175]

[172] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, *Towards common principles on flexicurity: More and better jobs through flexibility and security*,27 June 2017, COM(2007)359final, p. 9.

[173] It is worth mentioning that the EU used on a number of occasions the harmonization clause that is currently enshrined in Article 115 TFEU (see p. 19 above) to harmonize national laws related to the protection of employees (*e.g.* Council Directive 98/59 on the approximation of the laws of the Member States related to collective redundancies; Council Directive 2001/23 on the approximation of the laws of the Member States relating to the safeguarding of employee's rights in the event of transfers of undertakings, businesses, or parts of undertakings or businesses). However, as is the case with directives adopted on the basis of Article 153(2)(b), the ones relying on Article 115 also set *minimum* requirements.

[174] ILO website, http://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:11300:0::NO:11300:P11300_INSTRUMENT_ID:312303:NO.

[175] Recommendation 7(b).

FIRES

Social Security

Article 4(2)(b) of the TFEU confers upon the EU a shared competence with respect to social policy, as far as the aspects defined in the Treaty are concerned. In addition, Article 5(3) provides that "[t]he Union may take initiatives to ensure the coordination of the Member States' social policies". As mentioned, it is not entirely clear which aspects of social policy fall within the EU's shared competences and which are covered by Article 5.[176] More detailed provisions defining the EU's competence on social policy may be found in Title X ('Social Policy', Articles 151 through 161), but also in other places in the treaty. For instance, according to Article 21 the Council may adopt legislative measures concerning social security or social protection for purposes of facilitating the exercise of the EU citizens' right to move and reside freely within the territories of the Member States. In a similar vein, Article 48 requires that the Parliament and the Council adopt the legislative measures concerning social security necessary for ensuring the free movement of workers throughout the Union. More specifically Article 48 mandates arrangements for the "aggregation, for the purpose of acquiring and retaining the right to benefit and of calculating the amount of benefit, of all periods taken into account under the laws of the several countries", and for the "payment of benefits to persons resident in the territories of Member States". On the basis of what is now Article 48,[177] the Parliament and the Council adopted Regulation 883/2004 on the coordination of the social security systems of Member States.[178] Broadly, this piece of legislation regulates the interactions between the social security systems of Member State for purposes of ensuring the mentioned aggregation of social benefits and the payment of those benefits to EU nationals moving to another Member State. To illustrate, if a person works for a number of years in Member State X and then moves to Member State Y where he retires, the years of employment in Member State X will be aggregated with the years worked in Member State Y for purposes of determining whether the person satisfies the minimum number of years of employment needed for acquiring a pension in the former Member State. Moreover, his pension will be paid in the Member State of residence by each Member State where pension rights had been acquired – this is known as the exportability of social benefits. Additionally, Regulation 883/2004 requires Member States to give the same treatment to nationals of other Member States as the one given to their own nationals. It should be stressed that the rules of Regulation 883/2004 only concern the interactions between national security systems where EU nationals were sequentially insured in two or more Member States. As national security

[176] See p. 38 and n. 129 above.

[177] In conjunction with the flexibility clause (present Article 352, see p. 13 above).

[178] See also the subsequent amendments to Regulation 883/2004 and Regulation 987/2009 laying down the procedures for implementing Regulation 883/2004 on the coordination of social security systems.

systems are not harmonized, "each Member State remains free to design its social security system independently".[179] That is, "[e]very member state is free to decide who is to be insured under its legislation, which benefits are granted and under what conditions, how these benefits are calculated and what contributions should be paid".[180] Given the object and purpose of Articles 21 and 48 TFEU – *i.e.*, to ensure the portability of certain social benefits between Member States, we are of the view that they cannot be relied upon for adopting EU legislation to implement the FIRES recommendations on the portability of social insurance between jobs and between regular employment and self-employment.

As mentioned already, Title X of the TFEU, concerning social policy, contemplates both soft law approaches (Article 153(2)(a) and Article 156) and hard law harmonization by setting minimum standards (Article 153(2)(b)). The matters covered by Article 153 include "social security and social protection of workers" and "the modernization of social protection systems" (Article 153(1)). It should be noted that the latter is excluded from the scope of the power of the EU to set minimum standards by means of hard law (Article 153(2)(b)). Hence, while the Union may lay down minimum requirements with respect to "social security and the social protection of workers", "the modernization of social protection systems" may only be advanced by the EU by way of "measures designed to encourage cooperation between Member States through initiatives aimed at improving knowledge, developing exchanges of information and best practices, promoting innovative approaches and evaluating experiences" (Article 153(2)(a)). Article 156 makes available to the Commission similar instruments[181] for discharging its duty to "encourage cooperation between Member States and facilitate the coordination of their policies" regarding social security, among other things. The soft law approach envisioned by Articles 153(2)(a) and 156 is of the type specific to the Open Method of Coordination.

In principle, Article 153(2)(b) could be used for adopting legislation aimed at implementing the FIRES recommendations on the portability of social insurance, to the extent that this could be done by means of setting minimum standards. However, the use of Article 153(2)(b) in regard to "social security and social protection of workers" requires unanimity in the Council, which may be difficult to reach. Another constraint on the use of this provision can be found in Article 153(4) which requires

[179] Marion Schmid-Drüner, *Social Security Cover in Other EU Member States,* Fact Sheets on the European Union, European Parliament, June 2017, p. 1, http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuId=FTU_5.10.4.html.

[180] European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities, The EU provisions on social security: Your rights when moving within Europe*,* Publication Office of the European Union, 2011, p. 8.

[181] Making studies; delivering opinions; arranging consultations; establishing guidelines and indicators; organizing exchanges of best practices; and conducting periodic monitoring and evaluation.

that Directives adopted on the basis of Article 153(2)(b) not "not affect the right of Member States to define the fundamental principles of their social security systems and must not significantly affect the financial equilibrium thereof".

For the reasons set out above, we believe that the FIRES recommendations concerning social security should primarily be addressed to the Member States. Notwithstanding that, the EU may use the soft instruments contemplated by Articles 153 and 156 for promoting the desired outcomes. In addition, the Council may use to the general power given to it by Article 292 TFEU to issue recommendations to Member States. If framed appropriately, recommendations on the matter could also be made in the context of the European Semester.

It is perhaps worth mentioning that Commission Recommendation 2017/761 on the European Pillar of Social rights features recommendations concerning the social protection of self-employed persons. Thus, paragraph 12 of the Recommendation recognizes the right of self-employed persons to social protection under conditions equivalent to the ones enjoyed by regular employees. By the same token, paragraph 15(b) recognizes that the self-employed in retirement, alongside workers in retirement, "have the right to a pension commensurate to their contributions and ensuring an adequate income". Recommendation 2017/761 also included the following recommendation:

> Innovative forms of work that ensure quality working conditions shall be fostered. Entrepreneurship and self- employment shall be encouraged. Occupational mobility shall be facilitated.[182]

As explained in a document related to Recommendation 2016/761, "the facilitation of occupational mobility can entail […] a social protection system which fosters and facilitates career changes".[183]

The social protection of self-employed persons was also addressed by the Parliament in its resolution from 14 January 2014 on social protection for all, including self-employed workers, in which it called *on the Member States* "to develop, where necessary, social protection in relation to retirement, disability, maternity/paternity leave and unemployment so that social protection provisions for self-employed workers are better adapted to the needs of those workers" (para 32). The Parliament also urged the Member states to ensure access for the self-employed to pension schemes (para. 33).

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[182] Para 5(c).

[183] Commission Staff Working Document accompanying the *Communication from the Commission to the Council, to the European Parliament, to the Committee of the Regions*: *Establishing a European Pillar of Social Rights*, SWD(2017)final, 26 April 2017, p. 24.

7. The regulation of goods and services markets

Alongside natural barriers to entry, such as high set-up costs and economies of scale, there are also important artificial barriers imposed either by the government, through regulations, or by dominant companies engaging in anti-competitive conduct. Regarding government imposed barriers, excessive licensing requirements, restrictions and prohibitions on supplying certain services, such as health care and education services, are particularly problematic as they "may curb the rate of innovation and hamper productive entrepreneurship".[184] The past decades' deregulation, in developed countries, of economic sectors such as telecoms, energy productions, transportation and financial services, has greatly expanded the scope for high-impact entrepreneurship and often "led to impressive entrepreneurial performance".[185] The past positive experience with liberalizing monopolized markets suggests "a largely untapped productive potential in sectors such as health care, education, and care of children and the elderly".[186] As services markets "are particularly important for the future of the entrepreneurial ecosystem", their liberalization "promises to open entirely new arenas for private innovation and entrepreneurial venturing".[187]

Recommendations

> "Preventing market-leading incumbents from unduly exploiting their dominant market positions is essential. Lowered entry barriers are key to this reform area, as is the opening of those parts of the economy that are almost invariably closed to private production, such as healthcare and schooling. Within a well-designed system of public financing, sizeable private production and contestability should be encouraged."[188]

This is an area in which the EU enjoys far-reaching competences. While the power to regulate the internal market is a shared competence (Article 4(2)(a) TFEU), competition policy is an exclusive Union competence (Article 3(1)(b) TFEU) – to the extent that the anti-competitive conduct at issue has cross-border effects (Articles 101, 102 and 107 TFEU).

The internal market: free movement of goods and services and the right of establishment

[184] Elert et al., n. 2 above, pp. 51 and 52.
[185] Ibid., p. 52.
[186] Ibid.
[187] Ibid, p. 57.
[188] Ibid., p. 5.

The internal market is defined as "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" (Article 26(2) TFEU).

Free movement of goods and the mutual recognition of technical regulations

In addition to the prohibition of customs duties on intra-EU trade in goods (Article 30), the TFEU also prohibits quantitative restrictions on imports and exports between Member States, and 'all measures having equivalent effect' (Articles 34 and 35). The phrases 'quantitative restrictions' and 'measures having equivalent effect', present in Article 34 and 35, have been construed by the European Court of Justice (ECJ) in a very broad manner. The Court interpreted 'quantitative restrictions' as covering "measures which amount to a total or partial restraint of, according to the circumstances, imports, exports or goods in transit".[189] Such measures include bans on the export or import of a product, quotas setting maximum quantities of a product that may be imported or exported, or a refusal to issue an import or export license.[190] As for 'measures having equivalent effect', in an early landmark case, the Court held that "[a]ll trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-[EU] trade are to be considered measures having effect equivalent to quantitative restrictions".[191] This already broad definition was later expanded to include "[a]ny other measure which hinders access of products originating in other Member States to the Market of a Member State".[192] Most importantly for the purpose of this report, technical regulations – *i.e.,* measures regulating the physical characteristics, the production processes, the packaging and the labelling of goods – also have effects equivalent to quantitative restrictions to the extent that they prevent goods manufactured according to the technical regulations of the Member State of origin from being marketed in a different Member State.[193] Hence, according to the so-called *principle of mutual recognition*, first established in the ECJ's jurisprudence, where a good was lawfully produced according to the regulations of the Member State of origin, such a good can be marketed in all other Member States.[194] However, by way of exception, a Member State may still restrict the sale of an imported good that does not comply with its technical regulations where such a course of action is "necessary in order to satisfy mandatory

[189] C – 2/73, *Geddo v. Ente Nationale Risi*, para. 7.
[190] Barnard, n. 25 above, pp. 72 and 72.
[191] C – 8/74, *Procureur du Roi v. Dassonville*, para. 5.
[192] C – 110/05, *Commission v. Italy*, para. 37.
[193] Barnard, n. 25 above, pp. 36, 71 and 73. See also *Communication from the Commission concerning the consequences of the judgment given by the Court of Justice on 20 February 1979 in case 120/78 ('Cassis de Dijon').*
[194] C – 120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein*, para. 13.

requirements" related to an important public policy objective, such as safeguarding public health.[195] That is, the sale of the non-compliant imported good may be prohibited only if the good does not meet the standards of the importing Member State – for instance, safety standards.[196] The mutual recognition of technical regulations within the EU holds some importance for European entrepreneurial firms as it decreases the costs of exporting their goods to other Member States. The deregulating effect of mutual recognition certainly benefits all European firms exporting to other Member State, or intending to export, regardless of their type and size. However, it particularly benefits smaller firms, which in the absence of mutual recognition may find it too costly to adapt the specifications of their products to the technical regulations of each Member State. It is important to note, nonetheless, that in many sectors the technical regulations of Member States were harmonized through EU legislation, thus, obviating the need for mutual recognition.

Free movement of services

Pursuant to Article 56 of the TFEU, "restrictions on the freedom to provide services within the Union shall be prohibited in respect of nationals of Member States who are established in a Member State other than that of the person for whom the services are intended". In other words, European service providers, be it self-employed persons or companies, are entitled to provide services from their Member State of establishment to all other Member States. Such cross-border trade in services may take one of three possible forms: (1) the services is tele-supplied from one Member State into the other, without either the supplier or the consumer having to move across border (*e.g.*, legal advice given over e-mail); (2) the supplier travels to the Member State where the consumers is based (*e.g.*, a construction company from Member State A doing works in Member State B); and (3) the consumer travels to the Member State where the supplies is based (*e.g.*, a person travels abroad to receive medical treatment).

Similar to the approach taken by the Court with respect to the interpretation of the phrase 'quantitative restrictions and all measures having equivalent effect', 'restrictions on the freedom to provide services' has also been construed in a rather broad manner. According to established case-law, Article 56 does not only prohibit national measures (*e.g.*, license, authorization or qualification requirements) that discriminate, directly or indirectly, against foreign suppliers,[197] but also requires

[195] Ibid., para. 8. See also Article 36 TFEU, which may also serve as a tool for justifying marketing restrictions effected by means of technical regulations.

[196] *Communication from the Commission concerning the consequences of the judgment given by the Court of Justice on 20 February 1979 in case 120/78 ('Cassis de Dijon').*

[197] We use the term *foreign supplier* as meaning a supplier established in an EU Member State. Thus, suppliers from third-countries are excluded.

the abolition of any measure that is liable to prohibit or impede access to the services markets of the Member State in question, even where such measure is non-discriminatory. In the words of the ECJ:

> Article 56 TFEU requires not only the elimination of all discrimination on grounds of nationality against providers of services who are established in another Member State, but also the abolition of any restriction on the freedom to provide services, even if that restriction applies without distinction to national providers of services and to those of other Member States, which is liable to prohibit, impede or render less attractive the activities of a service provider established in another Member State where it lawfully provides similar services.[198]

To illustrate, the Court found that legislation allowing only persons who held a specified professional qualification, such as lawyer or patent agent, to supply patent monitoring services in Germany, with the consequence that a British firm was prevented from supplying such services in Germany, was in breach of Article 56. The Court did not see a valid reason for maintaining such a requirement.[199]

Furthermore, Article 56 also prohibits measures that result in imposing a double regulatory burden on foreign service providers. As held by the Court, restrictions on the freedom to provide services may arise "as a result of the application of national rules [...] to persons providing services established in the territory of another Member State who already have to satisfy the requirements of that State' s legislation".[200] Such a situation would occur, for instance, where a service provider that already holds a license for supplying a service in its home Member State is also required to obtain an authorization for the supply of that service in another Member State.[201]

However, restrictions on the freedom to provide services may be justified under certain circumstances. Thus, explicitly discriminatory national measures that run afoul of Article 56 may still be maintained if they are necessary for furthering public policy, public security or public health objectives (Article 52 TFEU read together with Article 62).[202] As for indirect discrimination and non-discriminatory restrictions, the Member States enjoy more room for justifying their measures. Thus, such restrictions may be justified by reference to 'overriding reasons in the public interest',[203] or 'imperative reasons relating to the public interest'.[204] As opposed to the closed list of grounds for justifications mentioned in Article 52 (*i.e.*, public policy, public security and public health), there's an open list of overriding, or imperative reasons. For example, consumer protection, the protections of workers, the protection of intellectual property, or the conservation of national, historic and artistic

[198] C-176/11, *HIT and HIT LARIX v. Bundesminister für Finanzen,* para. 16.
[199] C-76/90, *Säger v. Dennemeyer.*
[200] See, for instance, C-288/89, *Stichting Collectieve Antennevoorziening Gouda and others v Commissariaat voor de Media*, para. 12.
[201] See, for instance, C-205/84, *Commission v. Germany*, para 28.
[202] See, for instance, C-490/04 *Commission* v *Germany*, para. 86.
[203] See, for instance, *HIT and HIT LARIX*, n. 199 above, para. 20.
[204] See, for instance, *Säger*, n. 200 above, para. 15.

heritage, have all been recognized by the Court as being overriding reasons capable of justifying restrictions on the freedom to provide services.[205] Claiming that a measure is justified on the basis of an overriding public interest is not enough in order to save a national measure that breaches Article 56. For the Member State's defense to be accepted, the restriction of the free movement to provide services must also comply with the legal principle of proportionality, which requires the restriction to be proportionate to the legitimate objective pursued. In order for that to be the case, the measure at issue must be "be suitable for ensuring attainment of the objective pursued and not go beyond what is necessary in order to achieve that objective".[206] The proportionality requirement applies both when a Member State seeks to justify a measure on the basis of Article 52 and when it claims that the measure is justified on the basis of some other overriding public policy consideration.[207] As one last point on the limits of Article 56, services that are connected with the exercise of public authority are, in principle, excluded from the scope of the Treaty provisions on the free movement of services, including Article 56 (Article 51TFEU read together with Article 62).

It is important to bear in mind that Member States are under an obligation to modify their laws and regulations that have been found to be inconsistent with EU law.[208] Hence, if a national law or regulation is found to be incompatible with Article 56, and that measure cannot be justified under Article 52 or by reference to some overriding public interest, the Member State at issue must remove the inconsistency. Where the regulatory requirement that was found to be in breach of Article 56 (and not justified by some public interest) applied equally to foreign suppliers and domestic suppliers, it may be the case that the only way of removing the inconsistency is to scrap the requirement (e.g., a license or authorization) altogether, thus deregulating the market for that service. By reducing or removing entry barriers to services markets, such deregulation would, quite obviously, benefit both foreign suppliers and domestic suppliers, including small firms which may be of the entrepreneurial variety. Moreover, similar to the effects of the mutual recognition of technical regulations for trade in goods, the prohibition on measures imposing a double regulatory burden on foreign suppliers benefits small firms in particular – though, not only small firms. By reducing their costs of complying with the regulatory requirements that they may encounter in export markets, the prohibition on double burden makes it easier for them to export services to other Member States.

The right of establishment

[205] See, for instance, Gouda, n. 201 above**,** para. 14.
[206] See, for instance, *HIT and HIT LARIX*, n. 199 above, para. 22.
[207] C-100/01, *Ministre de l'Intérieur v Aitor Oteiza Olazabal,* para. 43.
[208] See, instance, C-162/99, *Commission v. Italy,* para. 22.

The right, or freedom, of establishment is defined as "the right to take up and pursue activities as self-employed persons and to set up and manage undertakings" in Member States other than the Member State of origin (Article 49 TFEU). In the words of the Court, "in accordance with well-established case-law, the concept of 'establishment' within the meaning of the Treaty is a very broad one, allowing [an EU] national to participate, on a stable and continuous basis, in the economic life of a Member State other than his State of origin".[209] According to Article 49, "restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited". The term 'nationals' refers to both natural persons and for-profit legal persons. In this regard, Article 54 clarifies that "[c]ompanies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall, for the purposes of [the provisions on the right of establishment], be treated the same way as natural persons who are nationals of Member States". Essentially, the right of establishment confers three prerogatives upon EU nationals. First, a natural person is entitled to pursue an economic activity, as a self-employed person, on a stable basis in any Member State. Second, natural and legal persons may incorporate companies in any Member State, and companies may transfer their seat to another Member State. This is known as 'primary establishment'. And third, natural and legal persons may set up a 'secondary establishment' in another Member State that may be in the form a secondary office, an agency, a subsidiary, or a branch. A company's secondary establishment need not be incorporated.

As far as the provision of services is concerned, the main difference between the right of establishment and the freedom to provide services concerns the stable or transient nature of the stay of the supplier in the Member State where the service is consumed. Whereas the provision of services under the right of establishment entails a stable commercial presence of the supplier in the country where the service is received, supply under the free movement of services involves only the temporary presence, if any, of the provider in the country where the service is received. Consider the following examples for the sake of illustration. If a Romanian national sets up a constructions company in France, the works done by that company in France are covered by the right of establishment. However, if that company does some works in Belgium, and it has no permanent commercial presence in Belgium, those works are covered by the free movement of services.

As mentioned, restrictions on the freedom of establishment are prohibited by the Treaty. Given the similarities between the right of establishment and the freedom to provide services, the ECJ's jurisprudence on the former by and large parallels the case-law concerning the latter. Moreover,

[209] C-470/04, *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo*, para. 26.

violations of Article 49, on the freedom of establishment, may be justified by reference to the same exceptions and derogations as the restrictions on the free movement of services; that is, by reference to Article 52 (public policy, public security and public health considerations) or to overriding reasons in the public interest.[210] The observation made in this regard in the section on the free movement of services, are applicable *mutatis mutandis* to the right of establishment. Like in the case of the freedom to provide services, the provisions on the right of establishment do not apply to services that are connected with the exercise of official authority.

Similar to Article 56, on the freedom to provide services, Article 49 prohibits both discriminatory and non-discriminatory restrictions. For the purposes of this study we are primarily concerned with non-discriminatory restrictions related to services markets (*e.g.*, licenses, approvals, authorization or qualification requirements), as the elimination of such restrictions are more likely to lead to deregulation and to the removal or dampening of entry barriers for both foreigners and nationals. Paralleling the right of establishment and the freedom to provide services, the Courts considers "that the term 'restriction' within the meaning of Article 49 TFEU and Article 56 covers all measures which *prohibit, impede or render less attractive* [the exercise of] the freedom of establishment or the freedom to provide services".[211] To add further clarity, "the concept of restriction covers measures taken by a Member State which, although applicable without distinction, *affect access to the market* for undertakings from other Member States and thereby hinder intra-[EU] trade".[212]

The freedom of establishment allows services providers to challenge a vast array of regulatory requirements that curtail their ability of supplying a service, either by barring their market access altogether or by increasing their regulatory compliance costs. Whereas many of the restrictions on the freedom to provide services can be removed without deregulating the service market in questions for domestic suppliers too,[213] the removal of non-discriminatory restrictions on the right of establishment is likely to bring about some deregulation of the market in question for all European suppliers, including the national ones. For instance, removing the double regulatory burden for foreign suppliers providing services under the free movement of services may not affect the imposition of those requirements on domestic suppliers. However, where a non-discriminatory requirement is found to be inconsistent with freedom of establishment, unless the Member State in

[210] See, for instance, C-55/94*, Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano,* para. 37.

[211] See, for instace, C-577/11, *DKV aBelgium v Association belge des consommateurs Test-Achats ASBL*, para. 31 (emphasis added).

[212] Ibid., para. 33 (emphasis added).

[213] For instance, by exempting foreign suppliers from certain obligations when they are subject to similar requirement in their home state, thus avoiding double burden, or otherwise by introducing reverse discrimination; that is, maintaining the requirement for domestic suppliers and exempting the foreign providers.

question is willing to create a dual regulatory regime, one applicable to national suppliers (less favourable), and one applicable to foreign suppliers *established* there, it would remove the requirement altogether. For illustrative purposes, consider the following examples of regulatory requirements that have been found to be incompatible with the freedom of establishment:

- Quantitative restrictions, such as limitations on the number of suppliers that may operate in a geographical area;[214]
- Conditioning the granting of an authorization on having a minimum or maximum number of employees;[215]
- Conditioning the granting of an authorization for the setting up of an outpatient dental clinic on the existing of a need for new suppliers in the relevant geographic market;[216]
- Legislation that allows only persons qualified as pharmacists to operate pharmacies; although it was found to constitute a restriction on the freedom of establishment, the Court eventually held that the measure was justified by considerations related to the protection of public health;[217]

The Services Directive

The ECJ's jurisprudence on the right of establishment and the freedom to provide services was codified in Directive 2006/123 on services in the internal market, which was adopted with the objective of further liberalizing services markets in the Member States.[218]

As regards the freedom of establishment, the Directive concerns authorization requirements, prohibited regulatory requirements and so-called 'requirements subject to evaluation' (knows as 'suspect' requirements). With respect to authorization requirements, Article 9(1) demands that Member States not condition market access for services suppliers on obtaining an authorization, unless the authorization is non-discriminatory and necessary for fulfilling an overriding public interest objective. In the words of Article 9(1):

> Member States shall not make access to a service activity or the exercise thereof subject to an authorization scheme unless the following conditions are satisfied:
> (a) the authorization scheme does not discriminate against the provide in question;
> (b) the need for an authorization scheme is justified by an overriding reason relating to the public interest;
> (c) the objective pursues cannot be attained by means of a less restrictive measure, in particular because an *a posteriori* inspection would take place too late to be genuinely effective.

[214] C-464/05, *Commission v. Germany.*
[215] Ibid.
[216] C-169/07, *Hartlauer Handelsgesellschaft mbH v Wiener Landesregierung and Oberösterreichische Landesregierung.*
[217] C-531/06, *Commission v. Italy.*
[218] Barnard, n. 25 above, pp. 357 and 418.

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As for the prohibited requirements, Article 16 enjoins Member States from "mak[ing] access to, or the exercise of, a service activity in their territory subject to compliance" with 8 listed requirements. The following are examples of prohibited requirements listed in Article 16:

> 5) the case-by-case application of an economic test making the granting of authorisation subject to proof of the existence of an economic need or market demand, an assessment of the potential or current economic effects of the activity or an assessment of the appropriateness of the activity in relation to the economic planning objectives set by the competent authority; this prohibition shall not concern planning requirements which do not pursue economic aims but serve overriding reasons relating to the public interest;
>
> 6) the direct or indirect involvement of competing operators, including within consultative bodies, in the granting of authorisations or in the adoption of other decisions of the competent authorities, with the exception of professional bodies and associations or other organisations acting as the competent authority; this prohibition shall not concern the consultation of organisations, such as chambers of commerce or social partners, on matters other than individual applications for authorisation, or a consultation of the public at large;

Regarding the suspect requirements, Article 15 also contains a list of 8 requirements, which, although not prohibited, may only be enacted or maintained if justified by overriding reasons related to public interest. Following is an example of such a requirement: "quantitative or territorial restrictions, in particular in the form of limits fixed according to population or of a minimum geographical distance between providers". To be more precise, suspect requirements are only lawful if the satisfy the following conditions laid down in Article 15(3):

> a) non-discrimination: requirement must be neither directly nor indirectly discriminatory according to nationality nor, with regard to companies, according to the location of the registered office;
> b) necessity: requirements must be justified by an overriding reason relating to the public interest;
> c) proportionality: requirements must be suitable for securing the attainment of the objective pursued; they must not go beyond what is necessary to attain the objective and it must not be possible to replace those requirements with other, less restrictive measures which attain the same result.

These conditions are essentially the same as those imposed on authorization schemes and represent a codification of the case law concerning the justification of non-discriminatory restrictions on the freedoms of establishment and to provide services. Member States are under the obligation to notify the Commission if they intend to adopt or have adopted suspect requirements and explain their rationale. After examining the requirements, the Commission may order the Member State at issue to refrain from adopting or to abolish the requirements (Article 15(7)).

As far as the free movement of services is concerned, Article 16(1) of the Directive demands that Member State not make the exercise of a service activity subject to compliance with requirements that are not non-discriminatory and necessary for protecting a public interest related to public policy, public security, public health or the protection of the environment. Furthermore, Article 16(2) lists 7 suspect requirement that may only be enacted or maintained if justified according to the conditions

mentioned in the first paragraph of Article 16. The requirements falling under Article 16, and their rationale, are also subject to reporting to the Commission (Article 39(5)). The scope of application of Article 16 is restricted by Articles 17 and 18 which provide for certain derogations. In addition, Articles 1 and 2 carve-out certain services from the scope of application of the entire Directive, for instance, healthcare services, financial services, audiovisual services, private security services, etc.

Sectoral liberalization

The EU may also adopt legislation aimed at opening up the services markets of the Member States on a sectoral basis. Postal services are a case in point. The Member States' markets for postal services were gradually liberalized through the enactment of three successive directives.[219] Following the amendments brought by the so-called 'Third Postal Services Directive'[220] to the original Postal Services Directive,[221] Member States were mandated to achieve full market opening by the end of 2012.[222] As one of the cornerstone provisions of the amended Postal Services Directive,[223] Article 7(1) prohibits Member States from "grant[ing] or maintain[ing] in force exclusive or special rights for the establishment and provision of postal services". Although the amended directive still allows Member States to subject the provisions of postal services to authorization and licensing, they may only do so to the extent necessary for securing compliance with a pre-defined list of so-called essential requirements – such as the confidentiality of correspondence or the security of the network as regards the transport of dangerous goods – or for ensuring the provision of universal service (Article 9 and 2(19)). Article 9 further restricts the Member States' discretion by laying down a number of conditions that must be respected when using authorization and licensing schemes; for instance, authorizations must not be limited in number, except where it concerns undertakings designated to be universal service providers.

Similar gradual liberalization has been effected in other services sectors as well, such as in the energy sector with respect to the electricity and gas markets. Having started in the 1990s, the liberalization

[219] Directive 97/67 of the on common rules on the development of the internal market for Community postal services and the improvement of quality of service; Directive 2002/39 of the European Parliament and of the Council, amending Directive 96/67 with regard to the further opening to competition of Community postal services; and Directive 2008/6 of the European Parliament and of the Council, amending Directive 96/67 with regard to the full accomplishment of the internal market of Community postal services.

[220] Directive 2008/6, n. 220 above.

[221] Directive 97/67, n. 220 above.

[222] 16 of the then 27 Member States were required to achieve full market opening by 2010, while the remaining 11 were given time until the end of 2012 (Directive 2008/6, Articles 2 and 3). See *also Report from the Commission to the European Parliament and the Council on the application of the Postal Services Directive (Directive 97/67 as amended by Directive 2002/39 and 2008/6)*, 17 November 2015, COM(2015)568 final.

[223] Directive 97/67, as amended by Directive 2008/6, n. 220 above.

process underwent three stages. The third stage was prompted by the adoption of the so-called 'Third Energy Package', consisting of several legislative acts having as objective the promotion of competition in the electricity and gas markets.[224] Among other things, the electricity and gas directives,[225] provided for the unbundling of transmission systems/networks from generation and supply activities. That is, companies producing and/or supplying electricity and/or gas may not also control transmission systems. The rationale for the unbundling requirement is to ensure the non-discriminatory access to transmission systems. Where the network is controlled by a company engaged in production and/or distribution it has an incentive to restrict its competitors' access to the network.[226]

Competition law

As already mentioned, it is within the EU's exclusive powers to establish "competition rules necessary for the functioning of the internal market" (Article 3(1)(b) of the TFEU). The TFEU further develops on the EU's competence in the area in Articles 101 through 109. In addition to prohibiting agreements between undertakings, decisions of associations of undertakings and concerted practices that "have as their object or effect the prevention, restriction or distortion of competition within the internal market" (Article 101), the TFEU also prohibits the abuse of dominance by one or more undertaking that may affect trade between Member States (Article 102. The latter would take place where a company enjoying a dominant positions in a particular market engages in practices such as: "(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions; (b) limiting production, markets or technical development to the prejudice of consumers; (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts" (Article 102).

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[224] Directive 2009/72 of the European Parliament and the Council concerning common rules for the internal market in electricity and repealing Directive 2003/54; Directive 2009/73 of the European Parliament and the Council concerning common rules for the internal market in natural gas and repealing Directive 2003/55; Regulation 713/2009 of the European Parliament and of the Council establishing an Agency for the Cooperation of Energy Regulators; Regulation 714/2009 of the European Parliament and of the Council on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation 1228/2003; and Regulation 715/2009 of the European Parliament and of the Council on conditions for access to the natural gas transmission networks and repealing Regulation 1775/2005.

[225] Directive 2009/72 and Directive 2009/73, n. 225 above..

[226] DG Energy's website https://ec.europa.eu/energy/en/topics/markets-and-consumers/market-legislation. See also Commission Staff Working Document, *Ownership Unbundling: The Commission's Practice in Assessing the Presence of a Conflict of Interest Including in case of Financial Investors*, 8 May 2013, SWD(2013)177final.

Articles 101 and 102 of the TFEU are enforced both by the Commission and by National Competition Authorities.[227] It is important to note that EU competition law is applicable only to anti-competitive conduct which may affect trade between Member States. Where that is not the case, the anti-competitive conduct will fall under the application of national competition laws.

7.1 Summary and conclusions

The EU's competences for regulating goods and services markets are abundant. Not only that it can open up markets by enforcing the Treaty provisions on the free movement of goods and services and the freedom of establishment – the Commission may order Member States to remove legislative and regulatory restrictions on the movement of goods and services and the right of establishment –[228] but it can also do so by way of adopting secondary legislation and harmonizing national laws and regulations. Moreover, it can ensure competition in the markets by exercising its exclusive power to devise and enforce competition law addressing anti-competitive conduct that may affect trade between Member States. However, Member States also retain significant regulatory power. First, there is room for deviating from the Treaty rules for purposes of advancing overriding public policy objectives. Second, the power to regulate the internal market is a shared competence, meaning that Member States retain their power to regulate their own markets to the extent that a particular aspect of the market is not already regulated by EU law (Article 2(2) read together with Article 4(2)(a) TFEU). Third, national competition laws apply where the anti-competitive conduct does not have cross-border effects. For these reasons, the FIRES recommendations on the regulation of goods and services markets should equally be addressed to the EU and the Member States.

8. Bankruptcy and insolvency law

Entrepreneurship is experimental by its very nature. Inevitably, some projects will succeed, whereas others will fail. However, not all failed projects are to be considered a waste of resources.[229] First, ”the failure of a firm provides valuable information to other economic agents about whether an endeavor is profitable”.[230] And second, “the knowledge from failed projects and ideas can often be recycled and improved either in a restructured venture with new management or in a different firm”.[231] In fact, there are indications that “re-starters often possess valuable experience and

[227] Council Regulation 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty.
[228] The so-called ‘infringement procedure’ – see Article 258 TFEU.
[229] Elert et al., n. 2 above, p. 58.
[230] Ibid.
[231] Ibid.

business networks that increase their probability of success in the future".[232] Hence, the failures of the past can lay the foundations for future successes.[233]

Recommendations

"Entrepreneurial failure provides valuable information to other economic actors. Failed ventures must be discontinued so that their resources can be redirected to more productive uses. Bankruptcy law and insolvency regulation should therefore be relatively generous and allow for a 'second chance'. However, filing for bankruptcy should not be too easy, as that encourages undue exploitation and destructive entrepreneurship, harming creditors and the rest of the community."[234]

"In essence, the insolvency regulation should strive to protect inherently healthy and promising ventures. If they are too hastily shut down, with their remaining assets shifted out to creditors, the result may very well be excessive value destruction. If the operation itself is healthy, it is often sufficient that the current owners lose all their equity, that the debt is restructured and that the consortium of debtors find a new controlling owner after restructuring [fn]."[235]

There is no explicit legal basis in the Treaties for the EU to adopt legislation concerning bankruptcy and insolvency. However, the provisions of Article 81 of the TFEU, on judicial cooperation in civil matters,[236] and the harmonization clauses in Articles 114 and 115 (see pp. 17 and 19 above), may serve as legal bases for enacting EU law in this area.

Article 81 TFEU was relied upon for the adoption of Regulation 2015/848 on insolvency proceedings. The Regulation lays down rules concerning insolvency proceedings that have cross-border elements; that is, proceedings with respect to debtors who have assets and/or creditors in more than one Member State. For instance, the Regulation features provisions on: determining which national judiciary has jurisdiction over the opening of the proceedings; determining the applicable law; the coordination of the main proceedings and secondary proceedings that may have been opened in other Member States in regard to the same debtor; the recognition of insolvency proceedings by the authorities of another Member State; etc.

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[232] Ibid.
[233] Ibid.
[234] Ibid., pp. 5 and 85.
[235] Ibid., p. 59.
[236] Article 81 pertains to the so-called "area of freedom, security and justice", the regulation of which is a shared competence (see Article 4(2)(j) of the TFEU).

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Furthermore, the Commission proposed, in November 2016, the adoption of a Directive on 'preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures'.[237] The legal bases invoked for the adoption of the projected directive were Article 114 TFEU and Article 53 TFEU (allowing the adoption of harmonization measures for purposes of facilitating the exercise of the freedom of establishment). The Directive, if adopted, would establish minimum standards for the Member States' insolvency laws with respect to: (a) preventive restructuring procedures; (b) procedures leading to a discharge of debts incurred by over-indebted entrepreneurs and allowing them to take up a new activity – the title addressing such discharge procedures was suggestively named "Second Chance for Entrepreneurs"; and (c) the efficiency of restructuring, discharge and insolvency procedures more generally. Under the proposed rules, Member States must ensure that "debtors in financial difficulty have access to an effective preventive restructuring framework that enables them to restructure their debts or business, restore their viability and avoid insolvency" (Article 4(1)). The rest of the title addressing preventive restructuring develops on the elements of such restructuring frameworks. For instance, Article 5(1) requires that debtors undergoing preventive restructuring "remain totally or at least partially in control of their assets and the day-to-day operation of the business". As for title on second chances for entrepreneurs, following are a couple of examples of rules found in that section of the proposed directive. Thus, Article 20 provides that debt discharge procedures may not be longer than three years. As the directive would only set minimum standards, Member States are free to stipulate a shorter discharge period. The sooner an over-indebted entrepreneur can be fully discharged of its debts, the sooner it can start a new business. Another rule geared towards enabling entrepreneurs to re-start as soon as possible can be found in Article 21. According to that clause, Member States must ensure that "any disqualifications from taking up or pursuing a trade, business, craft or profession which is connected with the entrepreneur's over-indebtedness […] cease to have effect at the latest at the end of the discharge period, without the need to re-apply to a judicial or administrative authority". Regarding the general effectiveness of preventive restructuring, discharging of debts and insolvency proceedings, the Directive would set some horizontally applicable minimum standards concerning, for instance, the training of judges and other relevant officials, as well as the training, appointment, supervision and remuneration of practitioners dealing with such procedures.

[237] European Commission, *Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU,* COM(723)final, 22 November 2016.

The 2016 Commission's proposal for a Directive on preventive restructuring and second chance is related to, and builds upon, a 2014 Commission Recommendation on "a new approach to business failure and insolvency".[238] By way of that recommendation, the Commission encouraged the Member States "to put in place a framework that enables the efficient restructuring of viable enterprises in financial difficulty and give honest entrepreneurs a second chance" (para. 1). Substantively, the proposed directive on preventive restructuring overlaps, to a certain extent, with the Commission's 2014 Recommendation. For example, the Commission recommended that discharge procedures not exceed three years (para. 30). However, the proposed directive has a broader scope than the Recommendation.[239] It is worth nothing that assessments of the implementation of the Recommendation revealed that it did not have the expected impact, as a considerable number of Member States only partially implemented the recommendations.[240] It would seem that the failure of this endeavor is what lead the Commission, at least in part, to propose the adoption of a Directive (*i.e.*, a binding piece of legislation harmonizing national laws). As stated in the Explanatory Memorandum accompanying the proposed text for a directive,

> A binding instrument in the form of a Directive setting up a minimum harmonised framework appears necessary to achieve the policy objectives on restructuring, insolvency and second chance. The 2014 Commission Recommendation did not succeed in ensuring that Member States have a coherent and robust response to the problems it identified.

The 2014 Recommendation and the 2016 proposal for a directive show that the Commission is well aware of the desirability of pursuing the policy objective underlying the FIRES recommendations on bankruptcy and insolvency law, and has already taken steps to implement those objectives.

As we have seen, the EU may use the provisions of Article 81 TFEU, on judicial cooperation in civil matters, as well as the general harmonization clauses (Article 114 and 115 TFEU), coupled with other more specific provisions concerning the harmonization of national laws related to the internal market, as legal bases for adopting EU legislation on bankruptcy and insolvency. Where the EU law at issue takes the form of a directive, the Member States are bound to respect the by minimum standards set therein. However, in transposing the directive they are allowed to go beyond those minimum standards. As both the competence regarding the cooperation in civil matters and the power to regulate the internal market are shared competences, it means that both the EU and the Member States can shape national bankruptcy and insolvency laws. Member States are left some room for maneuver even in regard to aspects regulated by EU law, to the extent that those aspects

[238] Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency C(2014)1500final.

[239] *Proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of insolvency, restructuring and discharge procedures*, n. 238 above, Explanatory Memorandum, p. 9.

[240] Ibid, p. 8.

are subject to minimum standards established by a directive. Therefore, the FIRES recommendations on bankruptcy and insolvency law should be addressed to both the EU institutions and the Member States equally.

9. Incentives for human capital investment

There are many ways in which public policy may influence incentives for investment in human capital, the most obvious of them being the public funding of education. The prevalence of sufficient incentives to invest in human capital is a condition for the development of a knowledge-based entrepreneurial environment, as "entrepreneurial firms must be able to recruit highly competent people".[241] Strong academic credentials are common for both European and American successful entrepreneurs. However, "Europe's lack of elite universities (outside of the United Kingdom) compared to the United States is likely to be a disadvantage for the European Union's ability to develop Schumpeterian entrepreneurship".[242] By comparison to European universities, the US university system is more decentralized and more competitive. In addition, American universities are highly autonomous.[243] On the other hand, due to low tuition fees and government funding, the best European universities remain affordable.

Recommendations

"Policy should strive to create positive incentives for the individual to acquire knowledge and skills, whether through formal or workplace education. Incentives must also be developed by the education system itself to supply such opportunities. In this respect, the U.S. university system seems more responsive to the economic needs of society than European university systems. The U.S. system could be an important role model, as long as due attention is paid to European concerns regarding accessibility and equity."[244]

"The challenge for Europe is to retain its openness while increasing the quality of its universities. To meet this challenge, it must first be recognized that most European university systems are highly centralized; universities tend to be government owned, and the entry of private universities is disallowed or highly restricted [fn]. The government typically grants charters to universities and determines the rules of admission and the university's size (through budgetary allocations) as well as the size of specific fields of study. Such control makes individual institutions less flexible, for

[241] Elert et al., n. 2 above, p. 68.
[242] Ibid.
[243] Ibid.
[244] Ibid, pp. 5 and 84.

example when it comes to varying remuneration based on an individual professor's research and teaching performances or according to the economic value of the professor's field. A high degree of centralization also makes it more difficult for individual universities to adjust the allocation of research budgets across fields in response to changing demands outside of academia."[245]

"[U]niversities and other public institutions of learning need to become more entrepreneurial, flexible and adaptive towards market demand. Again, the challenge is to find the right balance between quality and accessibility and to be sensitive to the more egalitarian educational tradition in Europe while making the system of higher learning more dynamic and responsive to the needs of the entrepreneurial ecosystem."[246]

"[T]here is an obvious temptation for policymakers to expand inexpensive programs in order to boost university enrolment, since this is a relatively inexpensive way of giving the impression of investing a lot in human capital. Such actions would be illusory, and the damage would be exacerbated if such measures crowd out existing non-academic post-secondary education and vocational training at the upper secondary level."[247]

National education systems and training schemes remain primarily within the ambit of the Member States' competences.[248] Hence, the EU only enjoys limited powers in this area.[249] It's powers are broadly defined by Article 6(d) of the TFEU, which confers the EU institutions competences to *support, coordinate and supplement* the policies of the Member States in regard to "education, vocational training, youth and sport". More detailed provisions may be found in Articles 165 and 166, forming Title XII of the Treaty ('Education, vocational training, youth and sport'). Pursuant to Article 165(1), "[t]he Union shall contribute to the development of quality education by *encouraging cooperation* between Member States, and if necessary, by *supporting and supplementing* their action, *while fully respecting the responsibility of the Member States for the content of teaching and the organization of education systems* and their cultural and linguistic diversity" (emphasis added). The second paragraph of Article 165 further develops on the objectives to be pursued by the EU in

[245] Ibid., pp. 74 and 75.
[246] Ibid., p. 75.
[247] Ibid., p. 71.
[248] Michaela Franke and Mara Mennella, *Education and Vocational Training*, Factsheets on the European Union, European Parliament, February 2017, pp. 1 and 2, http://www.europarl.europa.eu/ftu/pdf/en/FTU_5.13.3.pdf; *Higher Education*, Factsheets on the European Union, European Parliament, February 2017, p. 1, http://www.europarl.europa.eu/ftu/pdf/en/FTU_5.13.4.pdf.
[249] Franke and Mennella, *Higher Education*, n. 249 above, p. 4.

order to fulfil its mandate to contribute to the development of quality education. Thus, the actions of EU must be aimed at:

> - developing the European dimension in education, particularly through the teaching and dissemination of the languages of the Member States,
> - encouraging mobility of students and teachers, by encouraging inter alia, the academic recognition of diplomas and periods of study,
> - promoting cooperation between educational establishments,
> - developing exchanges of information and experience on issues common to the education systems of the Member States,
> - encouraging the development of youth exchanges and of exchanges of socio-educational instructors, and encouraging the participation of young people in democratic life in Europe,
> - encouraging the development of distance education,
> […].

As for the implementation of this policy goals, the EU may adopt incentive measures (i.e., financial incentives, or funding) or issue recommendations (Article 165(4)). To be noted, is that Article 165 excludes “any harmonization of the laws and regulations of the Member States”.

Article 166 contains similar provisions with respect to vocational training: “The Union shall implement a vocational training policy which shall support and supplement the action of the Member States, while fully respecting the responsibility of the Member States for the content and organisation of vocational training” (Article 166(1)). A notable difference is that Article 166 does not mention incentive measures, but refers instead to the adoption of legislative “measures to contribute to the achievement of the objectives referred to in this article”. Those objectives are:

> - facilitate adaptation to industrial changes, in particular through vocational training and retraining,
> - improve initial and continuing vocational training in order to facilitate vocational integration and reintegration into the labour market,
> - facilitate access to vocational training and encourage mobility of instructors and trainees and particularly young people,
> - stimulate cooperation on training between educational or training establishments and firms,
> - develop exchanges of information and experience on issues common to the training systems of the Member States.

Like in the case of education policy, harmonization of national laws and regulations is excluded, and the possibility of issuing recommendations is explicitly mentioned.

The EU may also influence the education policies of Member States through mechanisms and processes of policy coordination, such as the Open Method of Coordination (OMC; see p. 23 above). In 2002, the EU established a policy coordination process for education and training based on the OMC. The ‘Education and Training 2010’ work program was established as the first solid framework for European cooperation on education and training.[250] The work program was “based on common

[250] Council Conclusions of 12 May 2009 on a strategic framework for European cooperation in education and training (‘ET2020’), 2009/C 119/02.

objective and aimed primarily at supporting the improvement of national education and training systems through the development of complementary EU-level tools, mutual learning and the exchange of good practice via the open method of coordination".[251] In 2009, that program was replaced by the 'Strategic framework for European cooperation in education and training (ET2020)'.[252] The Council Conclusions endorsing ET2020 emphasized, among other things, that "[e]fficient investment in human capital through education and training systems is an essential component of Europe's strategy to deliver the high levels of sustainable, knowledge-based growth and jobs".[253] The Conclusions also noted the EU's objective of "becoming world-leading knowledge economy" and laid out four, more specific strategic objectives: (1) making lifelong learning and mobility a reality; (2) improving the quality and efficiency of education and training; (3) promoting equity, social cohesion and active citizenship; and (4) enhancing creativity and innovation, including entrepreneurship, at all levels of education and training. To be noted is that these objectives partially overlap with the objectives listed in Articles 165 and 166 of the TFEU.

The implementation of the four strategic objectives through the OMC entails: periodic reporting and monitoring, on the basis of common reference tools and approaches, such as indicators and performance benchmarks; peer learning and exchanges of good practices, including dissemination activities, such as conferences and seminars; the use of evidence and data from all relevant European agencies, European networks, and international organizations; and making full use of the opportunities available under European programs. In addition, the Council stated that "financial resources from the European Structural Funds may be used [where appropriate] to enhance education and training systems in accordance with the overall strategic objectives and Member States' priorities".[254] The ET2020 strategic framework will run until 2020 and it is being implemented in cycles. Initially each cycle lasted for three years. However, it was extended to 5 years after the first two cycles.[255]

The European Semester, another mechanism for policy coordination, is also relevant as the country-specific recommendations issued yearly by the Council sometimes pertain to the education policies of the Member States. As noted in an evaluation report of ET2020, from 2014, "[a] substantial

[251] Ibid.
[252] Ibid.
[253] Ibid.
[254] Ibid.
[255] *Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions: Draft 2015 Joint Report of the Council and the Commission on the implementation of the Strategic framework for European cooperation in education and training (ET 2020) – New priorities for European cooperation in education and training,* COM(2015)408final, 26 August 2015, pp. 3 and 7.

number of topics developed under ET 2020 and the priority area [*sic*], have found their way in the CSRs [country specific recommendations]".[256] An example of such a CSR is to "[e]nhance cooperation between businesses, higher education and research institutions".[257] According to the Commission, the education related CSRs are "a key driver of reform".[258]

Furthermore, the EU set several policy objectives related to education and training in the context of its Europe 2020 strategy.[259] Under the so-called 'Flagship Intitiative: Youth on the Move', the Commission laid out a number of policy objectives to be pursued both at EU level, by the EU institutions, and at national level, by the Member States' governments. The overall aim of this 'Youth on the Move' initiative is to:

> […] enhance the performance and international attractiveness of Europe's higher education institutions and raise the overall quality of all levels of education and training in the EU, combining both excellence and equity, by promoting student mobility and trainees' mobility, and improve the employment situation of young people.[260]

The Commission listed the following objectives to be pursued at EU level:

> – To integrate and enhance the EU's mobility, university and researchers' programmes (such as Erasmus, Erasmus Mundus, Tempus and Marie Curie) and link them up with national programmes and resources;
> – To step up the modernisation agenda of higher education (curricula, governance and financing) including by benchmarking university performance and educational outcomes in a global context;
> – To explore ways of promoting entrepreneurship through mobility programmes for young professionals;
> – To promote the recognition of non-formal and informal learning;
> – To launch a Youth employment framework outlining policies aimed at reducing youth unemployment rates: this should promote, with Member States and social partners, young people's entry into the labour market through apprenticeships, stages or other work experience, including a scheme ("Your first EURES job") aimed at increasing job opportunities for young people by favouring mobility across the EU.[261]

As for the objectives to be implemented by the Member States at national level, the Commission proposed the following:

> – To ensure efficient investment in education and training systems at all levels (pre-school to tertiary);

[256] Ecorys, *Interim Evaluation of the strategic framework for European cooperation in education and training (ET2020)*, Final Report to the Directorate General for Education and Culture of the European Commission, October 2014, p. 25, https://ec.europa.eu/education/sites/education/files/education-training-2020-evaluation-2014_en.pdf.
[257] Ibid., p. 27.
[258] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions, *on a renewed agenda for higher education*, COM(2017)247final, 30 May 2017, p. 2.
[259] Communication from the Commission, *Europe 2020: A strategy for smart, sustainable and inclusive growth*, COM(2010)2020, 3 March 2010.
[260] Ibid., p. 11.
[261] Ibid.

> – To improve educational outcomes, addressing each segment (pre-school, primary, secondary, vocational and tertiary) within an integrated approach, encompassing key competences and aiming at reducing early school leaving;
> – To enhance the openness and relevance of education systems by building national qualification frameworks and better gearing learning outcomes towards labour market needs.[262]

In addition to the above objectives, the Commission proposed a further list of objectives related to higher education, in its 2011 communication: 'Supporting growth and jobs – An agenda for the modernization of Europe's higher education systems'. Like the 'Youth on the Move' initiative, that communication featured objectives for both the EU level and the national level. Below is an example of an objective for the national level.

> Stimulate the development of entrepreneurial, creative and innovation skills in all disciplines and in all three cycles, and promote innovation in higher education through more interactive learning environments and strengthened knowledge-transfer infrastructure.[263]

More recently, in May 2017, the Commission put forth yet another list of objectives on higher education. The stated rationale for the 'Renewed Agenda for Higher Education' was to "to ensure the EU's initiatives to support higher education modernisation are focused on issues that matter, while also helping to prepare for the next EU funding period".[264] In this regard the Commission identified four priorities for actions: (1) tackling future skills mismatches and promoting excellence in skills development; (2) building inclusive and connected higher education systems; (3) ensuring higher education institutions contribute to innovation; and (4) supporting effective and efficient higher education systems. Moreover, the Commission undertook to take a number of more specific actions – 20 actions in total – under each of the 4 priorities. Below are examples of actions proposed by the Commission under with respect to each of the 4 priorities.

Regarding the first priority – tackling future skills mismatches and promoting excellence in skills development – the Commission undertook to:

> Launch an up-scaled **EU STE(A)M** [science, technology, engineering, (arts) and maths] **coalition** [fn] bringing together different education sectors, business and public sector employers to promote the uptake of relevant STE(A)M subjects and modernise STE(A)M and other curricula, including through more multi-disciplinary programmes and cooperation between relevant faculties and HEIs [higher education institutions].
>
> Fn: Building on EU projects to date, including the EU STEM coalition. The evolution from STEM to STEAM reflects recognition within higher education of the increased importance of inter-disciplinary approaches. The interaction between STEM and art and design is driving substantive innovation and creativity.[265]

[262] Ibid.
[263] Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions: *Supporting growth and jobs – An agenda for the modernization of Europe's higher education systems*, COM(2011)567final, 20 September 2011, p. 8.
[264] Commission Communication *on a renewed agenda for higher education*, n. 259 above, p. 2.
[265] Ibid., pp. 5 and 6 (emphasis original).

Regarding the second priority - building inclusive and connected higher education systems – the Commission undertook to:

> Promote **development and testing of flexible and modular course design** to support access to higher learning through specific priorities for Erasmus+ strategic partnerships.[266]

Regarding the third priority – ensuring higher education institutions contribute to innovation – the Commission undertook to:

> Step up EU support for **university-business cooperation**, making the biannual University Business Forum a focal point for exchange on HEIs and regional development at European level and promoting the establishment of **regional and national university-business fora** across the EU.[267]

Finally, in regard to the fourth priority – supporting effective and efficient higher education systems – the Commission undertook to:

> Simplify student mobility by building on existing Erasmus+ projects for the **electronic exchange of student data** and explore the feasibility of establishing **electronic student identification systems** to allow cross-border access to student services and data.[268]

Finally, regarding incentives measures adopted pursuant to Article 165(4), the Erasmus+ program[269] is a salient example. The program is concerned with three policy areas: (1) education and training at all levels; (2) youth, particularly in the context of non-formal and informal learning; and (3) sport, particularly grassroots sport.[270] Erasmus+ is scheduled to run between 2014 and 2020[271] and was endowed with a budget of roughly EUR 14.77 billion.[272] A minimum 33.3% of the total budget was allocated to programs concerning higher education,[273] such as funding student and university staff mobility, funding a student loan guarantee scheme and funding the Erasmus Mundus Joint Master Degrees.[274] By incentivizing learning mobility, the Erasmus+ program brings an important contribution to the attainment of the first strategic objective of ET2020 – to make learning mobility a reality. Under that strategic objective, the Union seeks to make "learning periods abroad – both within Europe and the wider world – the rule rather than the exception".[275]

Given the limited competences enjoyed by the EU with regard to education, the recommendations on incentives for human capital investments should primarily be directed towards the Member

[266] Ibid., p. 7 (emphasis original).
[267] Ibid., p. 9 (emphasis original).
[268] Ibid., p. 11 (emphasis original; reference omitted).
[269] Regulation 1288/2013, of 11 December 2013, establishing 'Erasmus +': the Union programme for education, training, youth and sport and repealing Decisions No 1719/2006/EC, No 1720/2006/EC and No 1298/2008/EC.
[270] Ibid., Article 1(3).
[271] Ibid. Article 1.
[272] Ibid., Article 18(1).
[273] Ibid., Article 18(2).
[274] Franke and Mennella, *Higher Education*, n. 249 above, p. 3.
[275] Council Conclusions of 12 May 2009, n. 251 above.

States. However, the EU may also take action in this area and influence the Member States' policies through coordination processes, such as the OMC, by issuing recommendations, including in the context of the European Semester, or by adopting incentive measures.

10. R&D, commercialization and knowledge spillovers

High spending on research and development is a necessary but insufficient condition for an innovative economy. More spending on R&D will not necessarily result in more innovative entrepreneurship; that is, it will not necessarily lead to the commercialization of the knowledge produced by the researchers. That is so because knowledge generated by R&D does not automatically become economically exploitable knowledge. For entrepreneurs to be able to transform knowledge into economic knowledge that can be commercialized – by placing new products and services on the market, or by introducing new methods of production – they need to be operating in a well-functioning entrepreneurial ecosystem. Such an environment presupposes that it is easy to start a business and that individuals have strong incentives to behave in an entrepreneurial manner and to grow their businesses.[276]

Recommendations

"R&D spending is only an input; for it to translate into economic growth, entrepreneurs must exploit the inventions and created knowledge by introducing new methods of production or new products into the marketplace. Therefore, instead of focusing on quantitative spending goals and targeted R&D support, policy should more generally make it easier to start and grow businesses."[277]

Implementing the recommendation to "generally make it easier to start and grow businesses" would require taking initiatives pertaining to a wide range of specific policy areas – *e.g.*, corporate law, taxation, labor law, social security, banking, data protection, public procurement, sector specific licenses and authorizations, etc – and horizontal initiatives aimed at reducing red tape in general. Some of the requisite measures could potentially be taken at EU level, whereas others would be a matter for domestic policies to address, depending on the policy area and the nature of each specific measure. For this reason, the recommendation should be addressed to both the EU institutions and the Member States equally. However, it should be borne in mind that, in principle, EU law must be related to some cross-border element. Purely internal matters remain within the regulatory purview

[276] Elert et al., n. 2 above, pp. 62 – 65.
[277] Ibid, pp. 5 and 84.

of Member States. Hence, it is only the Member States that can systematically tweak their regulatory frameworks with a view of making it easier for entrepreneurs to start and grow businesses.

That being said, one way for the EU to generally contribute to the ease of doing business is by making sure that the firms' costs of compliance with EU laws are minimized. The European Commission is aware of the desirability of such a policy objective and it is, in fact, pursuing it. As part of its Regulatory Fitness Program (REFIT),[278] the Commission is seeking to simplify EU legislation, thus reducing regulatory compliance costs. In addition to ensuring that new regulations and directives are not more burdensome than necessary for achieving their objectives (*e.g.,* by running impact assessments and consulting stakeholders during the development stage), the Commission is also reviewing existing legislation with a view to simplify it. To that end, the Commission includes a number of legislative simplification initiatives each year in its work program.[279] As of 14 September 2016, almost 200 REFIT initiatives for burden reduction and simplification had been launched.[280] Examples of simplification initiatives include the reduction of financial reporting obligations for micro-enterprises and the significant reduction (up to 95%) of the registration costs borne by SMEs under the REACH (Registration, Evaluation, Authorization and Restriction of Chemicals) Regulation.[281]

The Commission is particularly concerned with the impact of EU laws on small and medium-sized (SMEs). Following the consultation of around 1000 SMEs and business organizations, the Commission identified, in 2013, the 10 most burdensome EU laws for SMEs.[282] Some of the identified laws are currently undergoing simplification under the REFIT program.[283]

[278] Website of European Commission, https://ec.europa.eu/info/law/law-making-process/overview-law-making-process/evaluating-and-improving-existing-laws/reducing-burdens-and-simplifying-law/refit-making-eu-law-simpler-and-less-costly_en.

[279] See, for instance, Annex II to the Commission Work Programme for 2017 (Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions: *Commission Work Programme 2017, Delivering a Europe that protects, empowers and defends*, COM(2016)710final, 25 October 2016).

[280] Communication from the Commission to the European Parliament, the European Council and the Council, *Better Regulation: Delivering better results for a stronger Union,* COM(2016)615final, 14 September 2016, p.5.

[281] Ibid.

[282] REACH (Registration, Evaluation, Authorization and Restriction of Chemicals) Regulation; VAT legislation; general product safety and market surveillance package; recognition of professional qualifications legislation; waste legislation; labor market-related legislation; data protection legislation; working time legislation; recording equipment in road transport (for driving and rest periods) legislation; procedures for the award of public contracts (public works, supply and service contracts); modernized customs code (European Commission, *Top 10 most burdensome EU laws for small and medium-sized enterprises: How the Commission is helping SMEs,* Memo, 7 March 2013, http://europa.eu/rapid/press-release_MEMO-13-168_en.htm.

[283] *E.g.*, VAT legislation, chemicals legislation, etc, https://ec.europa.eu/info/law/law-making-process/overview-law-making-process/evaluating-and-improving-existing-laws/reducing-burdens-and-simplifying-law/refit-making-eu-law-simpler-and-less-costly_en.

Apart from the simplification process under REFIT, the Commission is also looking into how the existing regulatory frameworks affect innovation – whether laws and regulations stimulate or hamper innovation. At the end of 2015, the Commission published a so-called 'staff working document' titled *Better regulation for innovation driven investments at EU level.*[284] The paper included case studies on the regulations pertaining to the following areas: (1) road vehicle automation; (2) assessments of health technology; (3) nanomaterials; (4) aircraft products certification; (5) eco-design for resource efficiency; (6) energy efficient buildings; (7) electric vehicles; (8) fuel cells and hydrogen technologies. Based on inputs from stakeholders, the Commission identified potential regulatory barriers to innovation in each of the 8 analyzed areas. As further analysis is required for better understanding how the regulatory frameworks impact innovation, the Commission undertook to "to collect further suggestions on the relationship between innovation and regulation, indications of regulatory barriers to innovation and suggestions for simpler, clearer and more efficient regulation supporting growth and jobs".[285]

11. The rule of law and the protection of property rights

The rule of law provides a favorable context to entrepreneurial activity in guaranteeing a clear, stable and fair legal system in which enterprises can deploy their activities, plan their investments and operations, and foresee the legal consequences of their actions and those of others. This view of the rule of law has been central in the thought of liberal thinkers such as Hayek,[286] which advocate for a view of the rule of law centered on legal certainty and the absence of arbitrariness, but also against too much legal interventionism from the authorities. This liberal approach is endorsed by FIRES Deliverable 2.1 when it states that "[t]he legal principle that a polity should not be governed by arbitrary decisions made by autocratic rulers or government officials is central to any country striving for prosperity".[287]

Central in the analysis of Deliverable 2.1 is the protection of the right to property, as the quote above goes on to state that "private property rights [and] the existence of legal titles to hold property and the protection thereof is arguably the most fundamental of all economic institutions and relevant for

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[284] Commission Staff Working Document, *Better regulation for innovation driven investments at EU level,* 2016, p. 13.
[285] Ibid.
[286] Friedrich Hayek, *The Road to Serfdom - Text and Documents: The Definitive Edition,* edited by Bruce Caldwell, Taylor and Francis, 2014, p. 112: '[S]tripped of all technicalities [the rule of law] means that government in all its actions is bound by rules fixed and announced beforehand – rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances, and to plan one's affairs on the basis of this knowledge.'
[287] Elert et al., n. 2 above, p. 22.

all actors in the ecosystem's skill structure".[288] The report argues that the protection of fundamental rights must be strong enough for entrepreneurs to make profits in exploiting their assets and avoid extortion and free-riding, but also not so strong as to create monopolies and make the economy less competitive.[289] The report then compares, based on World Bank data, the level of attainment of the rule of law and in particular the protection of property rights, which evidence disparities across the European Union along the following lines: "[t]he former Soviet-bloc countries score especially low on the rule of law, but this is also true for Greece and Italy and, to a slightly lesser extent, for Spain and Portugal. The top countries are the Nordic, Anglo-Saxon and Benelux nations. These are also the wealthiest EU countries."[290]

Recommendation

"Regarding the rule of law, the efficiency of government, and the protection of property rights we see no alternative for the laggard countries but to do their utmost to converge towards the level of the best-performing countries".[291]

In this section, we will examine what the EU's legal competence is with regard to the promotion of the rule of law (with a focus on the right to property) in Member States, but also in itself given that it wields considerable competences which are relevant to entrepreneurship.

The approach taken by D2.1 calls for two points to be made. The first one has to do with the minimalist vision of the rule of law adopted, and the second has to do with the possibility of 'convergence' of Member States with regard to the rule of law and the relevance of so-called 'best practices'.

First, it is not a secret that the rule of law is a very contested concept, and many have argued that 'thin' conceptions such as the one presented by Deliverable 2.1 (basically simply guaranteeing a clear and simple legal framework in which rights and obligations – *e.g.,* those related to private property – are independently adjudicated and effectively enforced) is not all there is to the notion of the rule of law. Many have argued for a thicker conception of the rule of law, which would also entail for the legal system to respond to procedural and substantive requirements, such as implementing democratic decision making, protecting fundamental rights, and delivering substantive justice in

[288] Ibid. (references omitted).
[289] Ibid., p. 23.
[290] Ibid., p. 24.
[291] Ibid., p. 26.

society (which would entail the possibility to question the premises of the liberal approach focused on protecting private property).[292]

European and other leading international organizations[293] seem to have adopted a rather thick approach. To illustrate, the UN defines the rule of law as:

> The 'Rule of Law' is a concept at the very heart of the Organization's mission. It refers to a principle of governance in which all persons, institutions and entities, public and private, including the State itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards. It requires, as well, measures to ensure adherence to the principles of supremacy of law, equality before the law, accountability to the law, fairness in the application of the law, separation of powers, participation in decision-making, legal certainty, avoidance of arbitrariness and procedural and legal transparency.[294]

The OSCE stated that:

> the rule of law does not mean merely a formal legality which assures regularity and consistency in the achievement and enforcement of democratic order, but justice based on the recognition and full acceptance of the supreme value of the human personality and guaranteed by institutions providing a framework or its fullest expression. [D]emocracy is an inherent element of the rule of law.[295]

Finally, the EU developed its own conception of the rule of law, starting with the European Court of Justice which, in 1986, ruled that

> the European Economic Community is a community based on the rule of law, inasmuch as neither its Member States nor its Institutions can avoid a review of the question whether the measures adopted by them are in conformity with the basic constitutional charter, the Treaty. […] The treaty established a complete system of legal remedies and procedures designed to permit the Court of Justice to review the legality of measures adopted by the institutions.[296]

This definition insists on the notions of legality and judicial review, which are essential for legal certainty, but later on, the EU adopted a definition of the rule of law close to that of the Council of Europe's Venice Commission, according to which:

> It seems that a consensus can now be found for the necessary elements of the rule of law as well as those of the Rechtsstaat which are not only formal but also substantial or material (materieller Rechtsstaatsbegriff). These are: (1) Legality, including a transparent, accountable and democratic process for enacting law (2) Legal certainty (3) Prohibition of arbitrariness (4) Access to justice before

[292] Paul Craig*, Formal and Substantive Conceptions of the Rule of Law: An Analytical Framework*, Public Law, 1997, p. 467.

[293] Laurent Pech, *Promoting the Rule of Law Abroad: On the EU's Limited Contribution to the Shaping of an International Understanding of the Rule of Law*, in Dimitry Kochenov and Fabian Amtenbrink (eds), *The European Union's Shaping of the International Legal Order*, Cambridge University Press, 2013.

[294] UN Security Council, Th*e Rule of Law and Transitional Justice in Conflict and Post-Conflict Societies – Report of the Secretary-General*, UN Doc. No. S/2004/616, 23 August 2004, p. 4, para.6.

[295] OSCE, *Document of the Copenhagen Meeting of the Conference on the Human Dimension of the CSCE*, 29 June 1990, paras. 2–3, p. 3, http://www.osce.org/odihr/elections/14304?download=true.

[296] C - 294/83, *Parti écologiste 'Les Verts' v European Parliament*, para 23.

> independent and impartial courts, including judicial review of administrative acts (5) Respect for human rights (6) Non-discrimination and equality before the law.[297]

Therefore, if it is generally not contested that 'the rule of law' is more likely to be conducive to entrepreneurship and to a healthy economic climate, it should not necessarily be limited to the protection of private property, or to other factors evoked in Deliverable 2.1 based on World Bank surveys such as 'regulatory quality' or 'government effectiveness'. Rather, the rule of law seems to encompass a wider view of the legal system, whereby it not only provides a stable framework protecting citizen's expectations, but also one that captures the populations' values and aspirations, thereby leading to a society free of violence and oppression (physical or otherwise), which also in their own right to the overall (economic) climate of a country.

Second, one must treat with some caution the agendas which aim to make countries converge towards a predefined model for the rule of law. As stated above, the rule of law is a very contested notion, and the ideal it represents is arguably attained in different ways by different societies. It can therefore be asked whether rule of law promotion strategies beyond the very basic requirements of having functioning and independent law-making and law-enforcement institutions (which for instance are the focus of transitional justice programmes[298]) are realistic.

The EU provides a good case-study in this regard, as it seeks to put candidate countries on a convergence path regarding the rule of law through its enlargement policy. The so-called 'Copenhagen criteria' for accession to the EU mention that

> Membership requires that the candidate country has achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities, the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union. Membership presupposes the candidate's ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union.[299]

Candidate countries must therefore comply with these criteria and catch up with the legal Union *acquis* before joining the EU. The Commission has therefore developed a number of 'chapters' which contain benchmarks to be achieved by these countries. Two of these chapters, namely 'judiciary and fundamental rights' (Ch. 23)[300] and 'justice, freedom and security' (Ch. 24)[301], pertain to the rule of

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[297] Venice Commission, *Report on the Rule of Law Adopted by the Venice Commission at Its 86th Plenary Session (Venice, 25-26 March 2011)*, Study No. 512/2009, CDL-AD(2011)003rev 10, 4 April 2011.

[298] UN General Assembly, *The Rule of Law and Transitional Justice*, n. 295 above.

[299] Presidency Conclusions of Copenhagen European Council, 21 and 22 June 1993, para 7. A. iii., http://europa.eu/rapid/press-release_DOC-93-3_en.htm?locale=en.

[300] See the short description at European Commission, 'Chapters of the Acquis': "EU policies in the area of judiciary and fundamental rights aim to maintain and further develop the Union as an area of freedom, security and justice. The establishment of an independent and efficient judiciary is of paramount importance. Impartiality, integrity and a high

law. The content and the implementation of these chapters have been the object of quite some scrutiny of late, and have attracted much skepticism as to their ability to actually promote the rule of law in candidate countries.[302] In fact, the case of several more recent Member States and former members of the Eastern bloc, having starkly different legal system and institutional set ups than their Western neighbours, has been pointed as evidence of this fact: while joining only in 2004 and having complied with all the requirements put forward by the Copenhagen criteria, they are now engaged in a process of what some have called 'rule of law backsliding', through which governments are seeking to undermine some of the foundations of the EU-induced rule of law such as judicial independence (see below).

This is not to deny that promotion of the rule of law can be useful at some junctures to ensure a healthy environment favorable to entrepreneurship, but one must be wary of expecting too much from rule of law promotion, and should certainly not hope that full integration into a defined 'rule of law-compliant' model of legal system is possible.

11.1. EU competence and action regarding rule of law promotion

Protection of the right to property

In furtherance to the conclusions of Deliverable 2.1, let us delve into an analysis of how the EU may promote the right to property in a manner which is conducive to entrepreneurship. We will first analyze how the EU does this in its own legal order, before looking at the EU's competence to promote and protect intellectual property rights in the Member States' legal orders.

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standard of adjudication by the courts are essential for safeguarding the rule of law. This requires a firm commitment to eliminating external influences over the judiciary and to devoting adequate financial resources and training. Legal guarantees for fair trial procedures must be in place. Equally, Member States must fight corruption effectively, as it represents a threat to the stability of democratic institutions and the rule of law. A solid legal framework and reliable institutions are required to underpin a coherent policy of prevention and deterrence of corruption. Member States must ensure respect for fundamental rights and EU citizens' rights, as guaranteed by the acquis and by the Fundamental Rights Charter". (http://ec.europa.eu/enlargement/policy/conditions-membership/chapters-of-the-acquis/index_en.htm)

[301] See ibid: 'EU policies aim to maintain and further develop the Union as an area of freedom, security and justice. On issues such as border control, visas, external migration, asylum, police cooperation, the fight against organised crime and against terrorism, cooperation in the field of drugs, customs cooperation and judicial cooperation in criminal and civil matters, Member States need to be properly equipped to adequately implement the growing framework of common rules. Above all, this requires a strong and well-integrated administrative capacity within the law enforcement agencies and other relevant bodies, which must attain the necessary standards. A professional, reliable and efficient police organisation is of paramount importance. The most detailed part of the EU's policies on justice, freedom and security is the Schengen acquis, which entails the lifting of internal border controls in the EU. However, for the new Member States substantial parts of the Schengen acquis are implemented following a separate Council Decision to be taken after accession.'

[302] Dimitry Kochenov, *EU Enlargement and the Failure of Conditionality: Pre-Accession Conditionality in the Fields of Democracy and the Rule of Law,* Kluwer Law International, 2008.

In the EU itself

The right to property is a human right recognized *e.g.* by the Universal Declaration of Human Rights (Article 17), the European Convention of Human Rights (Article 1 Protocol 1) and indeed, the EU Charter of Fundamental Rights (Article 17), which reads:

> 1. Everyone has the right to own, use, dispose of and bequeath his or her lawfully acquired possessions. No one may be deprived of his or her possessions, except in the public interest and in the cases and under the conditions provided for by law, subject to fair compensation being paid in good time for their loss. The use of property may be regulated by law in so far as is necessary for the general interest.
> 2. Intellectual property shall be protected.

Even though as per Article 6(1) TEU the Charter has the same value as the Treaties, the inclusion of the right to property in the Charter does not mean that the EU has a competence to *legislate* in relation to the right to property. Indeed, Article 6(1) TEU and Article 51(2) state that the Charter does not expand the scope of competence of the EU as described in Article 2 ff. TFEU. Therefore, the Charter's function is rather to keep EU institutions, policies and legislations in check so as to ensure that they do not impinge on the right to property.

Let us however note that the right to property is not absolute. Deprivation of property (expropriation) is for instance permitted under the conditions laid out in Article 17(1) of the Charter; and the use of one's property may be 'regulated' under two conditions: only 'in so far as is necessary' (proportionality) and only 'for the general interest'. The fulfillment of these two conditions is scrutinized by the Court of Justice whenever it is seized with a claim that one's right to property has been unduly restricted. The financial crisis offered a good case in point of the admissibility of measures restricting one's enjoyment of property, notably as the bail out of some Member States' financial sectors under the European Stability Mechanism (ESM) often meant that significant losses would be incurred by shareholders or depositors, who then complained before the Court of Justice that their right to property had been tampered with.

One of the main issues with the judicial review of the bailout plans decided under the ESM is that it is located outside of the realm of EU law. It is an international organization in its own right, created by the 19 Eurozone members, with a view to providing financial assistance to Eurozone countries who, faced with financial problems, are not able to access financial markets.[303] In its now famous *Pringle* case, the CJEU recognized the right of Member States to set up such a stability mechanism, and confirmed that, even though the Commission, the European Central Bank (ECB) and the CJEU were

[303] See Treaty Establishing the European Stability Mechanism, signed on 2 February 2012, https://www.esm.europa.eu/legal-documents/esm-treaty.

granted important tasks under the ESM, this did not entitle them to make binding decisions on their own which would then be amenable to judicial review.[304] Likewise, the setting up of the ESM does not violate the principle of effective judicial protection protected by Article 47 of the Charter – which is instrumental in protecting fundamental rights, including the right to property – since by setting up the ESM, Member States are acting outside the scope of competence of the Union, which does not cover financial stability.[305]

Still, the Court adopted a less rigid stance regarding the review of bailout plans under the ESM in the context of the Cyprus bailout operations, by which, by virtue of a Memorandum of Understanding (MoU) signed between Cyprus and the ESM, the second largest bank of the country was wound down, and the largest was thoroughly restructured, with shareholders being wiped out and depositors suffering important losses.

The Court reviewed the effective role of the Commission and the ECB in hammering out this deal with the Cyprus authorities and stated the following:

> The Commission and the ECB were entrusted with the task of negotiating with the Cypriot authorities a macro-economic adjustment programme to be set out in the form of a memorandum of understanding. When the Commission and the ECB participated in the negotiations with the Cypriot authorities, provided their technical expertise, gave advice and provided guidance, they acted within the limits of the powers granted to them by Article 13(3) of the ESM Treaty. Participation of the Commission and the ECB, as envisaged by that provision, in the procedure resulting in the signature of the Memorandum of Understanding of 26 April 2013 does not enable the latter to be classified as an act that can be imputed to them.[306]

The MoU is thus not, in and of itself, a reviewable EU act, even against fundamental rights such as the right to property. However, the Court did not by the same token conclude that the actions of the Commission and the ECB were free of any oversight on its part. The reasoning of the Court in this regard is as follows:

> 53. As the Court pointed out in [the *Pringle* case], the duties conferred on the Commission and the ECB within the ESM Treaty, important as they are, do not entail any power to make decisions of their own. Furthermore, the activities pursued by those two institutions within the ESM Treaty commit the ESM alone.
> 54. In addition, […] the fact that one or more institutions of the European Union may play a certain role within the ESM framework does not alter the nature of the acts of the ESM, which fall outside the EU legal order.
> 55. However, [such a finding] cannot prevent unlawful conduct linked, as the case may be, to the adoption of a memorandum of understanding on behalf of the ESM from being raised against the Commission and the ECB in an action for compensation under Article 268 TFEU and the second and third paragraphs of Article 340 TFEU. […]

[304] C-370/12, *Thomas Pringle v Government of Ireland and Others,* para. 161.
[305] Ibid., para. 179.
[306] Joined Cases C-8/15 P to C-10/15 P, *Ledra Advertising Ltd and Others v European Commission and European Central Bank (ECB),* para. 52.

> 59. Consequently, the Commission […] retains, within the framework of the ESM Treaty, its role of guardian of the Treaties as resulting from Article 17(1) TEU, so that it should refrain from signing a memorandum of understanding whose consistency with EU law it doubts.

Therefore, even though the Commission (in this case) is confirmed as not wielding decision-making power in the ESM framework, it does not detract that, in the exercise of its wide-ranging functions (which consist in negotiating the bailouts), it must see to it that ESM's MoUs comply with EU law. Based on this premise, the Court deems admissible an action for damages based on Article 268 TFEU against the Commission for the way it acted in the framework of its functions regarding the Cyprus ESM. In doing so, the Court must research whether the Commission has acted unlawfully in not ensuring that the MoU complied with EU law. In this particular case, the EU law provision which was allegedly breached by the MoU was Article 17 of the Charter relating to the right to property.

The Court found in this regard that the Commission had not acted illegally, because the terms of the MoU did not amount to an illicit interference with the right to property of the claimants. Its reasoning is as follows:

> 74. In view of the objective of ensuring the stability of the banking system in the euro area, and having regard to the imminent risk of financial losses to which depositors with the two banks concerned would have been exposed if the latter had failed, such measures do not constitute a disproportionate and intolerable interference impairing the very substance of the appellants' right to property. Consequently, they cannot be regarded as unjustified restrictions on that right […].
> 75. In the light of those factors, the Commission cannot be considered, by dint of having permitted the adoption of the disputed paragraphs, to have contributed to a breach of the appellants' right to property guaranteed by Article 17(1) of the Charter.

Another area of law in which the right to property has been repeatedly invoked is the application of restrictive measures in the framework of the EU's Common Foreign and Security Policy (CFSP). These restrictive measures, which are expressly made subject to review by the Court (Article 24(1) TEU) – unlike other CFSP measures – often entail significant interference with the person subject to the measure's assets, such as the freezing of its funds, for the purpose of pursuing foreign policy objectives. These objectives include applying sanctions against Syria for the civil war or against Russia for the annexation of Crimea; preventing the financing of terrorism; or preventing nuclear proliferation, e.g. in Iran. The Court in this regard maintains a rather uniform case-law dating back to the famous *Bosphorus* case, denying any undue interference of these measures with the right to property, even though it has recognized that such restrictions could be 'considerable', in light of their scope and persistence.[307] In the recent *Rosneft* case,[308] reviewing (by means of preliminary

[307] Joined Cases C-402/05 P and C-415/05 P, *Yassin Abdullah Kadi and Al Barakaat International Foundation v Council of the European Union and Commission of the European Communities,* para. 369.
[308] C-72/15, *PJSC Rosneft Oil Company v Her Majesty's Treasury and Others.*

reference) a CFSP decision by which assets of the Russian Gas company Rosneft had been frozed, the Court declared:

> 148. [T]he fundamental rights relied on by Rosneft, namely the freedom to conduct a business and the right to property, are not absolute, and their exercise may be subject to restrictions justified by objectives of public interest pursued by the European Union, provided that such restrictions in fact correspond to objectives of general interest and do not constitute, in relation to the aim pursued, a disproportionate and intolerable interference, impairing the very essence of the rights guaranteed […].

Therefore, here again, the Court is prepared to accept quite wide-ranging restrictions of the right to property in the face of high stakes. And indeed, the threshold which the Court consistently applies when seized with claims of alleged violations of the right to property is quite high, namely that the measures under review must not 'constitute a disproportionate and intolerable interference impairing the very substance of the claimants' right to property'. The issue of proportionality is here central, as with any interference with fundamental rights, and relates to the aims pursued. The proportionality test measures whether the EU act does not go beyond what is necessary to achieve a legitimate objective. However, when the stakes are high, the Court takes a rather hands off approach and is prepared to recognize a wide margin of discretion to the EU institutions as to the measures to be taken so as to attain the high-stakes aim. In the *Rosneft* case, the Court words its approach as follows:

> 146. In so far as Rosneft challenges the proportionality of the general rules on the basis of which it was decided that it should be listed in the annexes to the contested acts, it must be noted, first, that, with regard to judicial review of compliance with the principle of proportionality, the Court has held that the European Union legislature must be allowed a broad discretion in areas which involve political, economic and social choices on its part, and in which it is called upon to undertake complex assessments. The Court has concluded that the legality of a measure adopted in those areas can be affected only if the measure is manifestly inappropriate having regard to the objective which the competent institution is seeking to pursue […].

The conclusion is that, even though the right to property is a fundamental right protected against undue interference by the EU institutions under the Charter of Fundamental Rights and subject to the review of the Court, the latter is prepared to condone quite wide-ranging restrictions to the right to property, particularly in times of crisis (economic, geopolitical, terrorist, etc).

In Member States

Let us now turn to a short analysis of how the EU can intervene to promote the right to property in its Member States, and act in case such right would be violated by a Member State. The starting point of this analysis is Article 345 TFEU, which provides that "[t]he Treaties shall in no way prejudice the rules in Member States governing the system of property ownership". Member States are therefore fully competent to determine how and to what extent property may be owned, transferred and regulated. In this regard, according to Article 51(1) of the Charter, Article 17 on the right to

property only applies to Member States 'when implementing EU law'. This means that Member States measures which would constitute a restriction of the right to property can only be reviewed by the Court if these measures fall within the scope of EU law. In this regard, the Court has already noted that Eurozone members were not acting within the scope of EU law when they set up the ESM, since the Treaties do not provide any EU competence to provide for financial stability.[309] Likewise, issues of restitution of property which has been confiscated by former Communist governments in some Member States are also deemed outside of the reach of the Charter because falling outside the scope of EU competences.[310]

However, the Court on occasion made a determination that the Member State was implementing EU law in cases entailing the right to property, and then went on to review Member States' actions in this light. Recently, in the context of the financial crisis again, the Court found that Romanian legislation which prohibited the combining of a net public-sector retirement pension with income from activities carried out in public institutions if the amount of that pension exceeded a certain threshold implemented EU law because it was adopted on the basis of a Memorandum of Understanding, based on Article 143 TFEU on the provision of financial assistance by the EU to Member States having difficulties with their balance of payments, and which provided for a reduction of the public sector wage bill in Romania. Discussing whether pension benefits could be regarded as 'property', the Court determined that "where legislation provides for the automatic payment of a social benefit, it generates a proprietary interest for persons […]. However, the right to property […] cannot be interpreted as entitling a person to a pension of a particular amount […]."[311] Considering then the issue of the right to property, the Court referred to – and confirmed – its *Ledra* ruling in the following terms:

> 55. [It] must be observed, first of all, that […] that law is of an exceptional nature and is intended to be temporary. In addition, it does not call into question the very principle of the right to a pension, but restricts its exercise in well-defined and limited circumstances, namely, when the pension is combined with a professional activity carried out in public institutions and when the amount of the pension exceeds a certain threshold. Thus, Law No 329/2009 is consistent with the essential content of the right to property […].
> 56. Next, […] the purpose of Law 329/2009 is to rationalise public spending in an exceptional context of global financial and economic crisis. [It] aims to achieve both the objective of reducing public sector wage costs and that of reforming the pension system, which were laid down by Decision 2009/459 and by the Memorandum of Understanding with a view to reducing the balance of payments difficulties that led Romania to seek and to obtain financial assistance from the European Union. Such objectives are objectives of general interest.

[309] *Ledra Advertising*, n. 307 above, para. 67.

[310] European Commission, *Report on the Application of the European Union Charter of Fundamental Rights 2010*, Publication Office of the European Union, 2011, p. 37, http://ec.europa.eu/justice/policies/rights/docs/report_EU_charter_FR_2010_en.pdf.

[311] C-258/14, *Eugenia Florescu and Others v Casa Judeţeană de Pensii Sibiu and Others*, para. 50.

> 57. As regards the suitability and necessity of the national legislation […] given the particular economic context, Member States have broad discretion when adopting economic decisions and are in the best position to determine the measures likely to achieve the objective pursued.
> 58. Moreover, Law No 329/2009 does not impose a disproportionate and excessive burden on the persons concerned by the prohibition on combining a retirement pension with income from an activity carried out in a public institution given that, on the one hand, they have to choose between the payment of their pension or of that income only where the amount of their pension exceeds the national average gross wage which was the basis for drawing up the State's social security budget, and that, on the other, they may at any time decide to terminate their employment relationship and receive their pension again […].
> 59. Accordingly, the national legislation at issue in the main proceedings is capable of attaining the general interest objective pursued and is necessary to attain that objective.[312]

Therefore, the Court confirms the non-absolute character of the right to property, the public interest character of maintaining the integrity of public finances, which justifies significant interferences to the right to property, and the wide discretion enjoyed by public authorities in times of economic crisis.

One of the aspects of property which is essential in fostering entrepreneurship is intellectual property, by which entrepreneurs can reap the fruits of their intellectual creations. Deliverable 2.1 rightly underlines that the protection of intellectual property must not be too high, so as to avoid that the holders of intellectual property rights would end up being unfairly advantaged, thereby disrupting the market. Recently, the Court was notably faced with the question of potential conflict between intellectual property rights and other rights relevant to entrepreneurship, such as the right to conduct a business (Article 16 Charter). In the *Scarlet* case,[313] the Court was faced with a preliminary reference submitted by a Belgian Court to verify the compatibility with EU law of an injunction sought by an association representing copyright holders against an Internet service provider to the effect of forcing the latter to install, as a preventive measure against copyright violations a system filtering all electronic communications passing via its services, applying indiscriminately to all its customers, exclusively at its expense, and for an unlimited period. This injunction, which was notably supported by Article 17(2), was found to nonetheless fail to 'reach a fair balance' between protection of intellectual property rights and other rights such as the right of the provider to conduct a business and the right of its customers to the protection of their personal data (Article 8 Charter). The Court thus here again insists on the limits to be imposed to the protection of (intellectual property) in the face of other interests.

Fight against backsliding

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[312] Ibid.

[313] C-70/10, *Scarlet Extended SA v Société belge des auteurs, compositeurs et éditeurs SCRL (SABAM).*

Beyond the issue of intellectual property, the EU has been engaged for some years in a battle to generally promote and protect the rule of law in a number of Member States which are experiencing what has been called 'rule of law backsliding'. The Member States most affected by this trend are currently Hungary and Poland, where the governments have been engaged not so much in an erosion of the protection of the right to property, but rather in attacks against the separation of powers and the independence of the judiciary. It can be argued that such descent into authoritarianism may have adverse effects on entrepreneurship as it has consequences on the choices made by present or future entrepreneurs. Hungary, for instance, has been reported to suffer a severe brain drain, with young and highly educated workers leaving 'in droves', partly as a result of the political context.[314] This trend is damaging the chances for companies to recruit highly skilled workers, but also that talented individuals or established enterprises will choose Hungary to start or develop their activities.[315]

This is not the place to discuss in detail these deliberate attacks on the rule of law, as this has been done extensively elsewhere,[316] suffice it to say that the EU institutions have struggled to find an appropriate response to counter effectively these attacks on the rule of law. Article 7 TEU is available to protect the values of the EU, including fundamental rights and the rule of law, and allows for the imposition of sanctions (up to the suspension of voting rights in the Council) in case of a grave and persistent breach of the EU's values. However, this procedure is considered as a 'nuclear option' and requires unanimity in the Council to be adopted. It has therefore long been considered out of reach, although the First Vice-President of the Commission Frans Timmermans, recently declared in the press that the Commission was 'very close' to proposing the activation of Article 7 against Poland to the Council.[317] Another issue has been that, since Article 7 requires unanimity to move to sanctions, two or more Member States which have a common agenda to erode the rule of law and who are under threat of a sanction under Article 7 may 'protect' each other by voting against the measure.[318] However, in the absence of a current possibility or desirability of Article 7 action, the Council, the Commission and the Parliament have all sought to seize themselves of the matter and to establish mechanisms to address the issue. The Council has set up a yearly dialogue on the rule of law, though it falls way short of a peer review process and is not meant to single out any Member State in

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[314] See https://budapestbeacon.com/hungarys-brain-drain-young-and-highly-educated-leaving-in-droves/
[315] See https://budapestbeacon.com/official-brain-drain-damaging-hungarian-economy/ and http://www.thefiscaltimes.com/latestnews/2015/11/03/Investors-feel-impact-Hungarys-brain-drain.
[316] Jacques Rupnik, Surging Illiberalism in the East, 27 Journal of Democracy, 2016, p. 77.
[317] See https://euobserver.com/justice/138568
[318] Kim Lane Scheppele, *Can Poland be Sanctioned by the EU? Not Unless Hungary is Sanctioned Too*, Verfassungblog, 24 October 2016, available at http://verfassungsblog.de/can-poland-be-sanctioned-by-the-eu-not-unless-hungary-is-sanctioned-too/.

particular. It is rather a more thematic event, researching how to respond to new developments in a way which complies with EU values. The 2016 dialogue was for instance dedicated to migration.[319] Its softness however casts doubts on the effectiveness of this mechanism.[320]

The European Parliament has sought to apply political pressure on rogue Member States by multiplying resolutions urging governments to mend their ways and the Institutions to step up.[321] The EP notably was the first major institution to openly call for the activation of Article 7, in this case against Hungary.[322]

The Commission perhaps came up with the most ambitious mechanism, amidst doubts as to its competence to act in the field of rule of law promotion within Member States.[323] The Commission's 'Framework to Strengthen the Rule of Law' works in three stages: (i) a thorough assessment of the situation by the Commission; (ii) a dialogue with the Member State; and the possibility of (iii) swift and concrete remedial actions.[324] This framework has been so far only activated against Poland in early 2016, and the Commission has issued three recommendations thus far.[325] So far the Polish government has appeared rather unfazed by the probe (except for a veto of two contested laws by the Polish President), bitterly defending its planned reforms, vowing to pursue them no matter what, and accusing the Commission of meddling into internal affairs.[326]

In addition to the little promising rule of law framework, the Commission has also sought to combat the measures which it thought were plainly in conflict with EU law by means of infringement

[319] Presidency of the Council of the European Union, Presidency non-paper for the Council (General Affairs) on 24 May 2016 – Rule of law dialogue, 13 May 2016, http://data.consilium.europa.eu/doc/document/ST-8774-2016-INIT/en/pdf.

[320] Peter Oliver and Justine Stefanelli, Strengthening the Rule of Law in the EU: The Council's Inaction, 54 Journal of Common Market Studies, 2016, Issue 5, p. 1075.

[321] European Parliament resolution of 25 October 2016 with recommendations to the Commission on the establishment of an EU mechanism on democracy, the rule of law and fundamental rights (2015/2254(INL)).

[322] European Parliament resolution of 17 May 2017 on the situation in Hungary (2017/2656(RSP)), para. 9.

[323] Council of the European Union Legal Service, *Commission's Communication on a new EU Framework to strengthen the Rule of Law: Compatibility with the Treaties*, Doc. No. 10296/14, 27 May 2014, http://data.consilium.europa.eu/doc/document/ST-10296-2014-INIT/en/pdf.

[324] European Commission, 'A New EU Framework to Strengthen the Rule of Law', Communication to the European Parliament and the Council, 11 March 2014, COM(2014) 158 Final.

[325] Commission Recommendation 2016/1374 of 27 July 2016 regarding the rule of law in Poland**;** Commission Recommendation 2017/146 of 21 December 2016 regarding the rule of law in Poland complementary to Recommendation 2016/1374**;** *Commission Recommendation of 26 July 2017 regarding the rule of law in Poland* complementary to Commission Recommendations 2016/1374 and 2017/146, C(2017) 5320 final.

[326] Laurent Pech and Kim Lane Scheppele, *Illiberalism Within: Rule of Law Backsliding in the EU*, forthcoming in *Cambridge Yearbook of European Legal Studies* 2017, p. 11.

procedures before the Court, though this strategy can only lead as far as the legal disputes at hand and cannot on its own bring about structural change.[327]

11.2. Summary and conclusions

The CJEU has competence to review EU measures and Member States measures implementing EU law for undue interference with the right to property. The above analysis has shown that the CJEU was prepared to grant a quite wide margin of discretion to EU and Member State authorities when it came to limiting the right to property, all the more in times of crisis, the standard being that the measures taken must not be 'intolerable' and deprive the right to property of its essence. Should such anti-crisis measures persist and with them sometimes wide-ranging limitations on the right to property, the latter may be significantly watered down and the faith of entrepreneurs in the steady protection of their assets may be weakened.

Another worrying development regarding the rule of law is the process of 'backsliding' at play in some Member States, which the EU institutions have so far not been able to reverse. This may also have long and enduring consequences for entrepreneurship in these countries as it will affect the decisions of present and future entrepreneurs to establish and develop their activities in those countries.

In conclusion, it is recommended that EU and Member States policy-makers exercise caution as to the impact that emergency measures such as bailout plans or restrictive measures may have on the right to property, lest they discourage potential entrepreneurs and investors. This is all the more so since the threshold of illicit interference with the right to property defined by the CJEU is fairly high.

Second, with regard to the phenomenon of "rule of law backsliding" which is currently ongoing in some Member States, it is recommended that EU and other Member States step up their efforts to limit attacks on rule of law institutions such as the independent judiciary or the free media, so as to foster not only a free and open society in line with Europe's values in these countries, but also a friendly climate for entrepreneurs. Soft actions in this regard are currently ongoing and are demonstrating their limits. Harder actions include triggering the Art. 7 TEU procedure, or limiting the availability of EU funds to Member States found lacking with regard to the EU's values.

Even though matters pertaining to the rule of law and the regulation of property rights mainly fall within the scope of the Member States' powers, the above analysis has shown that the right to

[327] Michael Blauberger and R. Daniel Kelemen, *Can Courts Rescue National Democracy? Judicial Safeguards against Democratic Backsliding in the EU*,24 Journal of European Public Policy, 2017, Issue 3, p. 321.

property is protected as a fundamental right in the EU, and that the EU had tools at its disposal to verify that it is effectively protected. Moreover, the EU is making efforts to ensure that the principles essential to the rule of law are upheld by the Member States. For these reasons, we are of the view that that the recommendations concerning the rule of law and the protection of property rights should be addressed to Member States and the EU institutions equally.

12. Conclusions

In the present study we analyzed the legal implications of the agenda to reform the EU's entrepreneurship policy as laid out in FIRES Deliverable 2.1 – Institutional Reform for Enhanced Innovation and Entrepreneurship: An Agenda for Europe.[328] The aims of this study were threefold: (1) to determine whether the regulatory powers needed for implementing the recommendations made in Deliverable 2.1 lied at the EU level or at the national level of government; (2) to assess whether the recommendations were consistent with existing EU law and policy and whether there are any international conventions that would constrain their implementation; and (3) to determine if the recommendations should be addressed primarily to the EU institutions or primarily to the Member States, or to both levels of government equally.

According to the principle of conferral, the EU may only take a particular action to the extent that the Treaties authorizes it to do so. Broadly, the EU's competences belong to one of the three following categories: exclusive competences – concerning areas in which only the EU can legislate (e.g., customs union matters; monetary policy for the Eurozone); shared competences – concerning areas in which both the EU and the Member States can regulate, with EU legislation pre-empting national legislation (e.g., the regulation of the internal market); and competences to carry out actions to support, coordinate or supplement national measures (e.g., in the area of education and training). The EU's use of the competences bestowed upon it by the Treaties must be compliant with two other principles. Pursuant to the principle of subsidiarity – applicable only in areas not covered by exclusive competences – the EU may only act insofar as the objectives of the proposed action cannot be sufficiently achieved at the national level. In addition, the principle of proportionality requires that EU actions not exceed what is necessary for attaining the objectives of the Treaties. Moreover, all competences not granted by the Treaties to the EU remain with the Member States.

Based on the division of regulatory powers between the EU level and the national level of governance, we concluded that the Member States are generally the best placed to implement the

[328] Elert et al., n. 2 above.

majority of the FIRES recommendations made in Deliverable 2.1. The recommendations analyzed in this study pertain to 11 policy areas: (1) taxation of corporate income; (2) taxation of dividends and capital gains; (3) taxation of labor income; (4) taxation of stock options; (5) regulations governing savings capital and finance; (6) the organization of labor markets and social insurance systems; (7) the regulation of goods and services markets; (8) bankruptcy and insolvency law; (9) incentives for human and capital investment; (10) R&D, commercialization and knowledge spillovers; and (11) the rule of law and the protection of property rights.

Having surveyed the powers granted to the EU in each of these areas, we are of the view that the greater part of the recommendations should primarily be addressed to the national governments, rather than to the EU institutions. That is the case with the recommendations pertaining to 6 out of the 11 policy areas – taxation of dividends and capital gains; taxation of labor income; taxation of stock options; regulations governing savings capital and finance; the organization of labor markets and social insurance systems; and incentives for human and capital investment. As for the remaining five policy areas, the recommendations concerning the taxation of corporate income should be primarily addressed to the EU institutions, whereas those related to: (1) the regulation of goods and services markets, (2) bankruptcy and insolvency law, (3) R&D commercialization and knowledge spillovers, and (4) the rule of law and the protection of property rights, should be addressed to the EU level and Member States equally.

Notwithstanding the fact the EU does not have any explicit competence on matters related to direct taxation, the recommendations concerning corporate taxation are the only recommendations we believe should be addressed primarily to the EU institutions. Despite having very limited powers in the area of direct taxation, the EU has launched a number of important initiatives, including legislative initiatives, that are directly relevant for the FIRES recommendation on corporate taxation to end "blatant institutional arbitrage and sweetheart deals between national governments and large multinational corporations".[329] The most salient of those initiatives are the Code of Conduct for Business Taxation, the legislative proposals on a Common Consolidated Corporate Tax Base and the state aid investigations into the tax rulings of certain Member States. Most importantly, the recommendations concern a problem that can only be adequately addressed at the EU level.

The recommendations on the regulation of goods and services markets mostly concern a shared area of competence[330] – that is, the regulation of the internal market. Although the EU has abundant

[329] Elert et al., n. 2 above, p. 32.
[330] Except for the part related to competition law, which is an EU exclusive competence.

powers to regulate the internal market, many aspects pertaining to trade in goods and services are still regulated at national level. For that reason, the recommendations should be addressed to both the EU and the Member States equally. The second set of recommendations to be addressed to both the EU and the Member States equally are those concerning bankruptcy and insolvency law. Like the regulation of goods and services markets, the regulation of bankruptcy and insolvency also falls within the scope of shared competences (the regulation of the internal market and judicial cooperation in civil matters). Thus, some aspects are regulated at national level while others at EU level. As mentioned, the recommendation on R&D, commercialization and knowledge spillovers should also be directed toward the EU and the Member States equally. The crux of the recommendation is to "generally make it easier to start and grow businesses".[331] Although it is only the Member States that have the ability to systematically adjust their national regulatory frameworks with a view of making it easier for entrepreneurs to start and grow businesses, EU legislation can also have an impact on the ease of doing business. For instance, the EU can contribute to improving the business environment by seeking to minimize the costs of compliance with EU legislation. The European Commission is aware of the desirability of such a policy objective and it is pursuing it in the context of it Regulatory Fitness Program (REFIT) aimed at simplifying EU legislation. The fourth set of recommendations to be addressed to Member States and the EU institutions equally are those concerning the rule of law and the protection of property rights. Even though matters pertaining to the rule of law and the regulation of property rights mainly fall within the scope of the Member States' powers, the right to property is protected as a fundamental right in the EU, which also has tools at its disposal to verify that it is effectively protected. Moreover, the EU is making efforts to ensure that the principles of rule of law are upheld by the Member States.

The fact that the certain recommendations should primarily be addressed to the Member States does not mean that the EU lacks any ability to contribute to the implementation of those recommendations. In the areas where the EU lacks meaningful powers to enact binding legislation, or to harmonize national laws, it may still influence the policies of Member States by means of issuing recommendations and organizing policy coordination processes. The European Semester is a salient example of a process of coordination of national policies entailing soft law in the form of country-specific recommendations.

Finally, we found that the analyzed recommendations were largely consistent with existing EU law and policy. In fact, in many of the considered policy areas, the EU has already been pursuing, or at least advocating for policy objectives similar to those underlying the FIRES recommendations made

[331] Elert et al., n. 2 above, pp. 5 and 84.

in Deliverable 2.1. Regarding the consistency of the recommendations with international law, we have not identified any international instrument that would impose any meaningful constraints on their implementation.

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