EUI WORKING PAPERS IN POLITICAL AND SOCIAL SCIENCES

EUI Working Paper SPS No. 93/1

Mutual Recognition In Federal Type Systems

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EUROPEAN UNIVERSITY INSTITUTE, FLORENCE

DEPARTMENT OF POLITICAL AND SOCIAL SCIENCES

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Printed in Italy in February 1993
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Mutual Recognition in Federal Type Systems *

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The aim of this paper is to analyze the possibilities and limits of mutual recognition as a general approach to economic and social regulation in federal-type systems. Mutual recognition and related regulatory techniques are playing a key role in the process of European economic integration. These developments will be discussed in some detail in the following pages. However, our purpose is less to study regulatory policymaking in the European Community (EC) *per se*, than to derive lessons and insights relevant also to other divided-power systems.

1. The Main Elements of the "New Approach"

In the White Paper on the completion of the internal market, the EC Commission proposed a new approach to regulation which includes among its key elements the strategy of "mutual recognition" of the rules and standards of one EC country by the other members. The immediate reason for introducing this new strategy was to reduce the burden on the Commission in harmonizing national rules. Despite the impressive growth of Community regulation in the 1960s and 1970s, by 1985 the Commission had to acknowledge that the amount of work that remained to be done was such that the goal of completing the internal market by 1993 could not be

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* This is the revised version of a paper presented at the conference on "Economic Integration in Federal Type Systems", Melbourne, Australia, 13-14 August, 1992.

achieved by relying exclusively on the traditional harmonization approach. In the words of the Commission (1985: 18) "experience has shown that the alternative of relying on a strategy based totally on harmonization would be over-regulatory, would take a long time to implement, would be inflexible and could stifle innovation".

Harmonization, rather than unification, of national regulations had been the main objective of the Community in its first 25 years. Harmonization is the adjustment of national rules to the requirements of a common market. Its characteristic instrument is the directive because this instrument only specifies the regulatory objectives to be achieved, leaving the choice of methods to the member states.

To overcome the limitations of the traditional approach, the Commission's White Paper introduced a new strategy with the following key elements: mutual recognition of national regulations and standards; legislative harmonization to be restricted to lay down essential health and safety requirements which will be obligatory on all member states; gradual replacement of national product specifications by European standards issued by the Comité Européen de la Normalisation (CEN) or by sectoral European organizations such as CENELEC in the electrical sector and CEPT in the telecommunications sector.

In essence, the White Paper proposed a conceptual distinction between matters where harmonization is essential and those where it is sufficient that there be mutual recognition of the equivalence of the various basic requirements laid down under national law. This line of reasoning was given prominence by the European Court of Justice (ECJ) in the famous Cassis de Dijon judgement of 1979. The Court had stated that a member state may not in principle prohibit the sale in its territory of a product lawfully produced and marketed in another member state even if this product is produced according to technical or quality requirements which differ from those imposed on its domestic

products -- except when the prohibition is justified by the need to ensure effective fiscal supervision, to protect public health or the environment, or to ensure the fairness of financial transactions.

Given the cumbersome nature of the Community decision-making process, the new approach has considerable advantages. Unlike harmonization, mutual recognition does not involve the transfer of powers to the Community but, at most, restricts the freedom of action of member states. Moreover, the emphasis on mutual recognition avoids all the difficulties linked to the necessity of drafting directives so as to suit the substantive concerns of twelve different actors or the particular requirements of their legal system. Finally, the new approach creates a competition among national regulators which, like competition among producers of goods and services, should provide an efficient way of assessing the costs and benefits of different methods of regulation and increase the range of choice available to consumers.

2. Essential requirements and performance standards

Before proceeding to a more detailed evaluation of these claims, let us take a closer look at the other elements of the new approach: restriction of harmonization to essential requirements of health and safety, and the gradual replacement of national standards by European (or international) standards. As noted above, the essential principle expressed by the ECJ in Cassis de Dijon, and extended by the Commission to the free movement of people and services, is that if a product is lawfully manufactured and marketed in one member state, there is no reason why it should not be sold freely throughout the Community.

Now, this normative principle rests on an empirical assumption, namely that "the objectives of national legislation, such as the protection of human health and life and of the environment, are more often than not identical" (COM(85):17). Only if this assumption is factually correct

does it follow that "the rules and controls developed to achieve those objectives, although they may take different forms, essentially come down to the same thing, and so should normally be accorded recognition in all Member States" (ib.).

But the essential equivalence of the safety and health objectives of the member states cannot be taken for granted. This is shown, for example, by the judgement of the ECJ in the "wood-working machines" case (Case no.188/84 ECR, 1986, p.419). In this case the Court was confronted with two different national approaches to safety: German regulation was less strict and relied more on an adequate training of the users of this type of machinery, while French regulation required additional protective devices on the machines. The Court ruled against the Commission which had argued that both regulations were essentially equivalent, and found that in the absence of harmonization at Community level, a member state could insist on the full respect of its national safety rules, and thus restrict the importation of certain goods.

Hence, mutual recognition cannot work without the harmonization of essential requirements of health and safety, and even this may not be sufficient, see below. To a large extent, the originality and value of the "new approach" depend on how the essential requirements are defined and on what is left to the sphere of voluntary technical norms. Each directive produced under this approach represents a compromise between measures judged to be in the public interest, and those aspects which may be entrusted to technical bodies in which industry is bound to have considerable influence (Waelbroeck, 1988).

A few examples may be helpful to understand how the Commission attempts to achieve a difficult balance between partially conflicting objectives: protection of the public interest, flexibility, economy and, of course, development of the integrated European market. In the first practical application of the new approach (the directive on simple

pressure vessels, COM(86) 112 of March 14, 1986) the Commission stated that the essential requirements should:

- create, after transformation into national law, legally binding obligations;
- grant the manufacturer the right to produce without following national or European standards, in which case the certification bodies should be able to check for conformity with the essential requirements;
- enable the Commission to confer on the European standards organizations mandates that are sufficiently precise.

It will be noted that the essential requirements are harmonized according to the so-called total method, i.e., the original national provisions are replaced by the new approximated provisions. Community rules become the sole regulation governing the area. However, a manufacturer may choose between two different ways to demonstrate that his products satisfy the essential requirements: he may apply European standards or, during a transitional period, national standards; or he may apply his own standard, but in this case he must be able to demonstrate to an approved certification body that his products conform to the essential requirements of the directive.

The logic of the distinction between essential requirements and technical specifications or norms becomes clearer if one recalls the familiar distinction between specification standards and performance standards. A regulation prescribing that ladders must have rungs at least one inch in diameter is using a specification standard, while a performance standard would say that the rungs must be capable of withstanding a certain maximum weight. It is well known that specification standards tend to stultify innovation, while performance standards foster flexibility and innovation, cut down red tape, and thus reduce cost. A new type of ladder made out of lighter but stronger material might be impermissible under the specification standard, but

acceptable under the performance standards. For these reasons it has been rightly said that the first victories for the economic approach to regulation, in the United States and elsewhere, have been in the replacement of many government specification standards by performance standards (Braithwaite, 1982).

Also in the European Community, the new approach, anticipated by the Low Voltage Directive of 1983, consists to a large extent in the replacement of a multitude of specification standards contained in the old-style directives by a few performance standards which a product must satisfy in order to secure the right of free movement throughout the common market. To take another example, the Toy Safety Directive (COM(88)378), does not tell the toy manufacturers how they should produce their toys. Rather, Annex II of the directive sets out broad performance standards concerning matters like the flammability and toxicity of the toy. Here again there are two methods of meeting the essential safety requirements. First, a toy can be made in accordance with European (CEN) standards. Alternatively, the manufacturer can seek approval for a toy which does not conform to CEN standards, but which nonetheless is claimed to meet the overall performance level. Specifications worked out by the experts at the CEN normally provide the easiest way of proving conformity with the performance standards defined in the directive. Innovation remains possible even if one relies on such specifications since (a) the specifications are non-binding, and (b) given the non-governmental nature of the CEN, they can be easily adapted to technical progress. Moreover, since harmonization is limited to the safety aspects of the product, national diversity is successfully preserved in the framework of a Community regulation (McGee and Weatherill, 1990).

The system outlined above is completed by the mutual recognition of testing and certification procedures. According to the doctrine developed by the ECJ in the case

Biologische Produkten, products covered by a directive harmonizing the essential requirements are presumed to conform to the directive if the importer presents a "moyen d'attestation reconnu". Accepted types of certification (typically, certificates issued by recognized laboratories) are defined in each directive. Thanks to the mutual recognition of certificates, products can circulate freely in the market of another member state on the basis of a single certificate issued in the country of production. At the same time, the Commission attempts to improve the quality of national certification bodies. Approved bodies must satisfy minimal requirements in terms of personnel, technical and financial resources, basic infrastructure, and so on.

3. Mutual recognition and the free movement of persons and services

"Mutual recognition" is not a slogan invented by Eurocrats only to speed up the "Europe 1992" programme. The expression already appears in the Treaty of Rome, Title III on free movement of persons, services and capital. Article 57(1) reads, in part: "In order to make it easier for persons to take up and pursue activities as self-employed persons, the Council shall ... issue directives for the mutual recognition of diplomas, certificates and other evidence of formal qualifications".

The Community has been active in the field of rights of establishment for self-employed professionals since the 1960s. In the 1970s the Commission proposed sectoral directives to facilitate professional mobility by harmonizing the conditions for access to and the exercise of various professions. This approach was relatively successful for the medical and paramedical professions, but little progress was made in other areas, notably law, architecture, engineering and the pharmaceutical profession.

In the 1985 White Paper on the completion of the internal market, the Commission announced its intention of

applying the Cassis de Dijon philosophy also to professional mobility. The strategy outlined in that document aimed at a general (rather than sectoral) system of recognition based on the following elements: the principle of mutual trust between the member states; the principle of the comparability of university studies between the member states; mutual recognition of degrees and diplomas without prior harmonization of the conditions for access to and the exercise of professions; and the extension of the general system to salary earners.

These principles find concrete application in Directive 89/48 on "a general system for the recognition of higher education diplomas awarded on completion of vocational courses of at least three years' duration". The system introduced by the directive is general in the sense that it applies to all "regulated" professions and to employed professionals as well as to the self-employed; and that it deals with both entry into and exercise of a profession.

Unlike the older, sectoral directives, the new directive does not attempt to harmonize the length and subject matters of professional education, or even the range of activities in which professionals can engage. It is well known that all these factors vary considerably from country to country. Instead, the directive introduces a system by which the states can compensate for such differences, without restricting the freedom of movement. Thus, if in country A training for a certain profession is shorter by at least one year than in country B, the latter can require that an applicant from country A have practical professional experience in addition to the formal education; the required professional experience cannot, however, exceed 4 years.

If the differences concern, not the length but the contents of the professional curriculum, the host country can demand that the applicant take a test or else acquire practical experience for a period not exceeding 3 years. The applicant is free to choose between these two "compensation

methods", while the competent authority of the host country has the burden of showing in detail the deficiencies in the diploma of the applicant. The procedure must be concluded within 4 months, ending with a reasoned decision which may be appealed in the courts of the host member state.

In conclusion, it can be said that Directive 89/48 creates, for the first time in Europe, a single market for the regulated professions. A member state no longer can deny access to, or the exercise of, a regulated profession on its territory to EC citizens who already exercise or could legitimately exercise the same profession in another member state. Moreover, the directive provides incentives for raising the level of professional education throughout the Community. This is because the citizens of a country that does not regulate adequately a certain profession are at a competitive disadvantage if they wish to use their professional skills beyond the national borders.

Another impressive application of the philosophy of mutual recognition is Directive 89/646 on credit institutions, often referred to, not quite correctly, as Second Banking Directive. The basic regulatory framework which will apply to European banks after January 1, 1993 is provided by this directive and by three more narrow directives concerned with the definition of a bank's capital, with the solvency ratios banks should adopt, and with procedures for winding up credit institutions. These three technical directives aim to harmonize prudential standards in key areas, not provide mutual recognition. They establish a firm basis on which mutual recognition can take place. As such they show that, as in our previous examples, harmonization and mutual recognition are not simply alternatives but are, in fact, complementary. The principle is always the same: ex ante harmonization only of basic prudential rules and of institutional and organizational conditions essential for the protection of consumers and of the public interest; all other conditions are defined and

controlled by the home country, and must be accepted by the other member states.

The essential elements of the Second Banking Directive are the concept of a single banking license and the list of permissible banking activities. The list is very broad and includes activities such as dealing in and underwriting securities. Not only is the list of permissible banking activities broad, but it can be updated by the Commission to reflect the emergence of new banking services.

Within the regulatory framework provided by the Second Directive and by the other directives mentioned above, a European bank will need a single license from its home country to be allowed to establish branches or directly market financial services in any other EC country without further authorizations or controls. With very few exceptions, the host country in which the bank provides its services has no power to seek further authorization or exercise supervision. This is, of course, a direct consequence of the principle of mutual recognition which inspires the entire directive.

It may be mentioned in passing that the approach followed by the EC in banking regulation has significant international implications (Majone, 1990b). For example, the mutual recognition approach, applied to international banking, would require the United States to permit European banks to carry on the same scope of business in the U.S. as their home country permits them to carry on in Europe. This would place American banks at a considerable disadvantage, unless the restrictions imposed by the Glass-Steagall and the McFadden Acts were greatly liberalized.

The European Community has repeatedly argued in favour of greater liberalization and international harmonization of banking regulation. Some progress has already been made, for example the adoption by the U.S. and Japan as well as the EC of the risk-based capital requirements set by the Basle Committee on Banking Regulations and Supervisory Practices.

Even stronger forms of regulatory convergence may emerge in the near future. According to some American experts, if the savings and loans crisis had not erupted to dominate all other financial market issues, the push coming out of reciprocity demands from the EC might have been the deciding factor in amending the Glass-Steagall Act in 1988 or 1989. It is also suggested that in the long run European banking regulation will induce a complete restructuring of the U.S. financial system, ending the limitations imposed by present American regulations (Golembe and Holland, 1990:93). How, in fact, could the U.S. Congress continue to defend, say, the prohibition of branching between American states when the EC permits virtually unrestricted branching between countries?

4. Mutual recognition and regulatory competition

After this brief review of the theory and practice of mutual recognition in the European Community we are in a position to evaluate the principle in more abstract terms. Two issues seem to be crucial for a correct assessment of mutual recognition as a regulatory technique: the advantages and limitations of competition among rules, and the thorny question of credibility and mutual trust among member states. While the two issues are related, it is analytically useful to discuss them separately, in the present and in the following section.

Mutual recognition is not an end in itself, but must be justified in term of the policy outcomes it may be expected to produce. According to its advocates, the great merit of the principle is that it replaces centralized by decentralized decision making, in the spirit of the subsidiarity principle, and thus makes possible competition among different regulatory approaches. Competition, it is argued, is an efficient way of assessing the costs and benefits not only of goods and services but also of different methods of regulation. By providing opportunities for experimentation and social learning, competition among

regulators can raise the standard of all regulation and drive out rules which offer protection that consumers do not, in fact, require (Kay and Vickers, 1990). The advantages of competition are clearest in the case of products which consumers are competent to evaluate. For example, if German TV standards are less costly than French standards but consumers regard German TV sets as essentially equivalent to the more expensive French sets, French producers will lose business to their German competitors. Hence they will bring pressure on their government to modify national TV standards. If other countries find themselves in a similar situation, competition among rules will eventually lead to convergence to the most cost-effective standard. The end result is ex post or bottom up harmonization, achieved through market processes rather than by public authorities as in the case of ex ante, or top down, harmonization. As we have seen, ex ante harmonization, limited to a few essential requirements, is still needed in order to avoid "excessive competition" among rules, or a race to the bottom leading to a general deterioration of health, safety and quality standards. The notion of ex post, market-driven harmonization is intuitively attractive but tells us nothing about the general features of the process that should lead to regulatory convergence. In general, there is no reason to believe that competition among rules will lead to a unique and efficient solution, rather than to several equilibria, none of which represents an optimum. A full discussion of this issue would require technical (game-theoretic) considerations beyond the scope of this paper, but we can at least mention a few factors that may impede the emergence of a single efficient set of rules.

First, for many products and services it is not realistic to assume that the consumer is able to evaluate the relevant cost-quality or cost-safety tradeoffs. In such cases, not the consumers but public authorities will decide whether certain price-quality or price-risk combinations are acceptable. This means that free competition among millions

of consumers is replaced by oligopolistic competition among a handful of state regulators. The instability and indeterminacy of oligopolistic competition are well known from economic theory. In the next section we shall see an illustration of this phenomenon, taken from the EC experience with the regulation of medical drugs.

Second, the time dimension, although seldom considered, is essential in evaluating the efficiency of competitive processes. Assume a situation where it is reasonable to think that competition among national rules will eventually eliminate the less efficient forms of regulation, leading to ex post harmonization. Unfortunately, it is usually impossible to estimate the speed of convergence toward the superior method. If convergence to the most efficient type of regulation is slow, producers in different countries may become committed to a particular system of standards which it would be too costly or difficult to change at a later stage. This is more than a theoretical possibility. Thus, in a highly original paper titled "Clio and the Economics of QWERTY", Paul David (1985) has shown how the QWERTY typewriter keyboard, developed in the 1870s when typing had to proceed slowly to avoid jamming, became standardized and fixed, even in the face of more efficient alternatives. For example, although a US Navy study found in the 1940s that the faster speed possible with the Dvorak keyboard would amortize the cost of retraining full-time typists within ten days, QWERTY remained the standard and large companies chose not to retrain their typists.

Technological anomalies of this type are not uncommon. As a distinguished economic historian writes, "[t]he persistence of narrow-gauge rails, the success of alternating current over direct current, and the survival of the gas engine over steam engine motor cars have all been used to illustrate the peculiar fact that incremental changes in technology, once on a particular track, may lead one technological solution to win out over another, even when,

ultimately, this technological path may be less efficient than the abandoned alternative would have been" (North, 1990:93).

These examples suggest that mutual recognition of technical standards may be least satisfactory in precisely those areas where the potential gains from a large integrated market are highest. Uniform technical standards are often needed in order to enable interconnection of specialized equipment, as in the case of telecommunications. Agreement on a common set of specifications is particularly difficult when several standards are equally satisfactory from a technical viewpoint so that there is no obvious reason why one standard should be given preference. The essential equivalence of many technical standards explains why in the telecom sector, the industry's regulators -- in Europe usually the national PTTs -- have traditionally been able to sustain their restrictive procurement practices by demanding observance of national standards reinforced by discriminatory certification procedures.

A third difficulty with the notion of competition among rules arises from the fact that for certain products like food, that are particularly sensitive from the viewpoint of public health and safety, mutual recognition is often possible only if the essential requirements are spelled out by detailed specifications contained in the directive itself. In this area it is not sufficient to set a few general requirements for the member states to fulfill their responsibility of protecting the health of their citizens. As a consequence, the distinction between traditional, ex ante harmonization and mutual recognition becomes blurred.

Extensive ex ante harmonization may also be necessary in practice because of product liability. In case of a liability suit, the courts will tend to make reference to the technical standards of their own country, and hence to decide against the producer who has not satisfied those standards. Thus, in the absence of more or less complete harmonization, the

foreign producer who has not met the standards of the importing country will be in a less favorable position than domestic producers with respect to product liability (Waelbroeck, 1988).

Finally, it is clear that competition among rules cannot be relied upon when the problem is how to manage negative externalities with transboundary effects such as air or water pollution crossing state borders. Also, there is fairly general agreement among the experts that the competitive structure of an integrated market has to be protected by central regulatory institutions against the interests of member states in anti-competitive regulations. This implies that the formulation and enforcement of competition rules should be the responsibility of the central authorities, except for products with only regional distribution.

5. Mutual recognition and mutual trust

An American student of EC affairs has noted that the mutual recognition approach "may require a higher degree of comity among member states than the commerce clause of the U.S. Constitution requires among individual states. The commerce clause has been interpreted by the U.S. Supreme Court to allow each state to insist on its own product quality standards -- unless the subject matter has been preempted by federal legislation, or unless the state standards would unduly burden interstate commerce" (Hufbauer, 1990:11).

It will be recalled, too, that the EC Commission listed mutual trust among member states among the main elements of the general system for the mutual recognition of university diplomas, see section 3. Indeed, absent mutual trust, the opportunistic behaviour of national regulators may wreck the delicate mechanisms through which mutual recognition operates. For example, even if it is assumed that mutual recognition of existing standards is operating satisfactorily, national authorities could bias their decisions on future standards toward low level of quality or

protection. Because approved products may be sold throughout the Community, national authorities could reason that much of the harm due to low standards will fall on consumers in other member states, while the cost savings will accrue to their own producers (Gatsios and Seabright, 1989).

The same problem can arise in many other areas of regulation. Thus, under the Second Banking Directive banks licensed in one member state can operate in another, see section 3. The Solvency Ratio Directive and Own Funds Directive attempt to ensure that bank licensing is conducted on a reasonably common basis. However, the application of the home country principle to the approval and supervision of banking services, coupled with the application of the host country principle for deposit insurance schemes, creates opportunities for strategic regulation by national authorities. As in the case of product standards, national regulators have incentives to set weak standards since foreign tax payers will pay the bill in case of bank failure. A process of "competitive deregulation" may set in as each country attempts to give competitive advantages to its domestically licensed institutions (Vives, 1990).

However, these are only theoretical possibilities. For an actual illustration of how national regulators' distrust can defeat the best strategy of mutual recognition, consider the EC experience with the mutual recognition of new medical drugs. For more than two decades, the Commission has attempted to harmonize national regulations for the approval of new medical drugs. The present system includes a set of harmonized criteria for testing new products, and the mutual recognition of toxicological and clinical trials -- provided they are conducted according to EC rules. In order to speed up the process of mutual recognition, a "multi-state drug application procedure" (MSAP) was introduced in 1975. Under the MSAP, a company that has received a marketing authorisation from the regulatory agency of a member state may ask for mutual recognition of that approval by at least

five other countries. The agencies of the countries nominated by the company must approve or raise objections within 120 days. In case of objections, the Committee for Proprietary Medicinal Products (CPMP) -- a group which includes experts from member states and Commission representatives -- has to be notified. The CPMP must express its opinion within 60 days; within another 30 days it may be overruled by the national agency that has raised objections.

The procedure has not worked well. Actual decision times are much longer than those prescribed by the 1975 Directive, and national regulators do not appear to be bound either by decisions of other regulatory bodies, or by the opinions of the CPMP. Because of these disappointing results, the procedure has been revised in 1983. Now only two countries have to be nominated in order to be able to apply for a multi-state approval. But even the new procedure has not succeeded in streamlining the approval process, since national regulators continue to raise objections against each other almost routinely. In sum, mutual recognition of national drug approvals has proved to be extremely difficult. The problem is that differences among national schools of medicine, different national attitudes in the evaluation of risks and benefits, and differently perceived needs for new drugs lead to divergent interpretations of drug approvals despite the fact that they have been prepared according to a standardised European format (Kaufer, 1990).

These difficulties have finally convinced the European Commission to propose the establishment of a European Agency for the Evaluation of Medicinal Products and the creation of a new centralized Community procedure, compulsory for biotechnology products and certain types of veterinary medicines, and available on an optional basis for other products, leading to a Community authorization (Commission of the European Communities, 1990).

The example just given suggests an additional hypothesis, namely that mutual distrust may be due also to

the low credibility of some state regulators. In a large supranational association credibility is seldom uniformly distributed among member states and across policy areas. For example, markets assess quite differently the commitment to price stability of the various central banks of the EC. Similarly, some states have low credibility as regulators because they lack, or are perceived as lacking, the scientific knowledge, financial resources, and policy infrastructure necessary to deal effectively with technically complex issues. Community assistance may be necessary in order to help all members achieve the level of competence needed to support mutual trust. As a recent study of new regulatory strategies in the EC points out, "the "Europeanisation" of expertise upon which a mutual recognition of risk assessment and consensus building may be built, presupposes the setting up of an infrastructure which not only ensures continuous cooperation between the Community and national administrations, but also an ongoing involvement of those communities of experts on which national administrative authorities rely" (Dehousse et al. 1992:15-16).

Although not inspired by the philosophy of mutual recognition, the U.S. Occupational Safety and Health Act of 1970 introduced some useful mechanisms for upgrading the quality of the regulatory resources of the states. Section 18 of the act provides that states desiring to regain responsibility for the development and enforcement of safety and health standards under state law, may do so by submitting and obtaining federal approval of a state plan. Once the governor of a state has designated an appropriate agency to formulate a plan, the state becomes eligible to receive federal funding. There are two main types of grant: developmental grants of up to 90 percent of a state's cost of preparing the plan; and operating grants only available to states whose plans have been certified as operational. The latter grants may be as high as half of the state's total

cost (ib.:43-52). Similar mechanisms may be needed in order to make mutual recognition a viable alternative to centralized regulation in a federal-type system characterized by significant regional inequalities.

6. Conclusions

Mutual recognition is a sophisticated and flexible instrument of regulation, especially appropriate for federal-type systems where state rights are jealously guarded. It has been used with great skill by the European Commission to produce innovative solutions like the Second Banking Directive and other recent directives in areas as varied as product safety and the recognition of professional diplomas.

The method is so attractive because it promises to achieve economic integration while preserving national and regional characteristics; to reduce the burden of centralized regulation without sacrificing essential safety requirements; and to promote experimentation and learning, but not unrestricted laissez-faire.

However, mutual recognition is not only a sophisticated and flexible, but also a very delicate instrument. Used without care or under the wrong conditions it could do more harm than good. Four main conditions for a successful application have been identified in this paper. First, recognition of the rules and regulations of one state by the other member states can be reasonably demanded only if it is assumed that all members pursue very similar public-interest goals, albeit by different means -- an assumption that must be empirically tested rather than being assumed *a priori*.

Second, mutual recognition must be supported by far-reaching harmonization of essential health and safety requirements in order to avoid competitive deregulation. Thus, harmonization and mutual recognition are complementary rather than alternative strategies.

Third, competition among regulators, like competition among goods and producers, must be protected and disciplined

by general rules if it is to lead to optimal results. We do not yet know enough about the nature of processes of regulatory competition to be able to specify what the rules of the competitive game should be; but we can at least point out that mutual recognition is not the appropriate response to certain types of market failure such as negative externalities (e.g., transboundary pollution) and monopoly power.

Finally, a system based on mutual recognition cannot work satisfactorily without mutual trust -- even if all other conditions are satisfied. But mutual trust among state regulators can no more be assumed than the essential identity of the health and safety goals of the member states. Rather, it is an important task of the central authorities to create the material and institutional conditions under which credibility and mutual respect become the most valuable public goods supplied by the supranational polity.

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