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Exporting standards: The externalization of the EU's regulatory power via markets

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ABSTRACT

This Article examines the unprecedented and deeply underestimated global power that the EU is exercising through its legal institutions and standards, and how it successfully exports that influence to the rest of the world. Introducing the notion of "the Brussels Effect," the Article shows how market forces alone are sufficient to convert EU standards into global standards. Without the need to use international institutions or seek other nations' cooperation, the EU has a strong and growing ability to promulgate regulations that become entrenched in the legal frameworks of developed and developing markets alike, leading to a notable "Europeanization" of many important aspects of global commerce. This Article identifies and explains the precise conditions for and the specific mechanism through which this externalization of EU's standards unfolds. Enhanced understanding of this dynamic explains why the EU is currently the only jurisdiction that can wield unilateral influence across a number of areas of law, ranging from competition and privacy to health and environmental regulation. This understanding also helps explain why certain regulations can be externalized via markets while others rely on the EU's ability to exert influence through its political agency. The Article further disputes the notion that the EU's ability to externalize its rules would reflect "regulatory imperialism," as critics have suggested. Instead, it argues that the EU's external regulatory influence has emerged largely as an inadvertent byproduct of its internal goal to create and strengthen the single market. The EU's regulatory authority has been further solidified as the markets, other states, and international institutions have been able to do little to constrain Europe's global regulatory power. In the end, as much as the rise of the EU's regulatory power is a product of its pursuit of internal goals, any limits to this power are likely to stem from within the EU itself.

1. Introduction[1]

It is common to hear Europe described today as a power of the past. Europe is perceived to be weak militarily. Its relative economic power is declining as Asia's is rising. Its common currency may be on the verge of disintegrating. On the world stage, the European Union is thought to be waning into irrelevance due to its inability to speak with one voice. Given its seemingly declining power status and inability to get its way alone, the EU is perceived as needing to retreat to weak multilateralism and international institutions (Rubenfeld, 2004; Bradford and Posner, 2011).[2]

Contrary to this prevalent perception, this Article highlights a deeply underestimated aspect of European influence that the discussion on global power politics overlooks: Europe's unilateral power to regulate global markets. The European Union sets the global rules across a range of areas, such as food, chemicals, the environment, competition, and the protection of privacy. EU regulations have a tangible impact on the everyday lives of citizens around the world (Mitchener, 2002; Scheer, 2003).[3] Few Americans are aware that EU regulations determine the make-up they apply in the morning, the cereal they eat for breakfast, the software they use on their computer, and the privacy settings they adjust on their Facebook page. And that's just before 8:30 a.m. The EU also sets the rules governing the interoffice phone directory they use to call a co-worker. EU regulations dictate what kind of air conditioners Americans use to cool their homes and why their children no

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[1] A longer version of this article, entitled "The Brussels Effect," was published in 107 Northwestern University Law Review 1 (2012).

[2] *See* European Commission, *Communication, The European Union and the United Nations: The choice of multilateralism*, at 1.1, COM (2003) 526 final (Sept. 10, 2003).

[3] *See Regulatory Imperialism*, WALL ST. J., Oct. 26, 2007 at 1; Case COMP/M.5984 *Intel/McAfee* (Commission decision of January 26, 2011), 2011 O.J. (C 98) 1.

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longer find soft-plastic toys in their McDonalds happy meals. This phenomenon—the "Brussels Effect"—is the focus of this paper.

This Article explains how and why the rules and regulations originating from Brussels have penetrated many aspects of economic life within and outside of Europe through the process of "unilateral regulatory globalization." Unilateral regulatory globalization takes place when a single state is able to externalize its laws and regulations outside its borders through market mechanisms, resulting in the globalization of standards. This process can be distinguished from political globalization of regulatory standards where regulatory convergence results from negotiated standards, including international treaties or agreements among regulatory authorities. It is also different from unilateral coercion, where one jurisdiction imposes its rules on others through threats or sanctions. Unilateral regulatory globalization is a development where a law of one jurisdiction migrates into another in the absence of the former actively imposing it or the latter willingly adopting it.

Critics of globalization have claimed that trade liberalization undermines domestic regulation. Extensive literature has emerged regarding the "race to the bottom" phenomenon—the idea that countries lower their regulatory standards in order to improve their relative competitive position in the global economy (Tonelson, 2000; Murphy, 2004). Recently, many of the assumptions driving this influential literature have been discredited (Vogel and Kagan, 2004). For example, fears of businesses relocating to pollution havens or capital flights following higher levels of corporate taxation have not materialized in large numbers.[4] Indeed, scholars have shown that international trade has frequently triggered a "race to the top," whereby domestic regulations have become more stringent as the global economy has become more integrated (Vogel, 1997; Vogel and Kagan, 2004; Spar and Yoffie, 2000; DeSombre, 2006). The "California Effect" is a term frequently used to describe this phenomenon: due to its large market and preference for strict consumer and environmental regulations, California is, at times, able to set the regulatory standards for all the other U.S. states (Vogel, 1995; Vogel and Kagan, 2004). Businesses willing to export to California must meet its standards, and the prospect of scale economies from uniform production standards gives these firms an incentive to apply this same (strict) standard to their entire production.

This Article explores the dynamics of the California Effect in a global context. It focuses on the conditions under which a single country can externalize its regulations on other countries. Building upon, yet going beyond, the literature on the California Effect, it argues that the following conditions are necessary for a jurisdiction to dictate rules for global commerce: the jurisdiction must have a large domestic market, significant regulatory capacity, and the propensity to enforce strict rules over inelastic targets (e.g., consumer markets) as opposed to elastic targets (e.g., capital). In addition, unilateral regulatory globalization presumes that the benefits of adopting a uniform global standard exceed the benefits of adhering to multiple, including laxer, regulatory standards. This is the case in particular when the firms' conduct or production is non-divisible, meaning that it is not legally or technically feasible, or economically viable, for the firm to maintain different standards in different markets.

Unpacking the determinants of unilateral regulatory globalization explains why the EU has become the predominant regulator of global commerce and why the EU can successfully export certain norms and not others. The EU has the world's largest internal market, supported by strong regulatory institutions. Trading with the EU requires foreign companies to adjust their conduct or production to the EU standards—which often represent the most stringent standards—else forgo the EU market entirely. Rarely is the latter an option. In addition, companies cannot undermine EU rules by moving regulatory targets to another jurisdiction because the EU primarily regulates inelastic consumer markets as opposed to more elastic capital markets. While the EU regulates only its internal market, multinational corporations often have an incentive to standardize their production globally and adhere to a single rule. This converts the EU rule into a global rule—a phenomenon described as the "de facto Brussels Effect." Finally, after these export-oriented firms have adjusted their business practices to meet the EU's strict standards, they often have the incentive to lobby their domestic governments to adopt these same standards in an effort to level the playing field against their domestic, non-export-oriented competitors. This latter phenomenon converts the de facto Brussels Effect into the "de jure Brussels Effect" (Vogel, 1995).

The Article then moves on to discuss the EU's motivations to externalize its regulations as well as the reasons why foreign corporations and governments generally adhere to, as opposed to challenge, the EU rules. It disputes the critics' notion that the Brussels Effect would reflect the EU's conscious effort to engage in "regulatory imperialism." Instead, it argues that the EU's external regulatory agenda is primarily, even if not exclusively, driven by a set of entrenched domestic policy preferences and the EU's efforts to create an internal market that reflects those preferences. The EU's external regulatory influence has thus emerged largely as an inadvertent by-product of that internal goal rather than as a result of some conscious foreign policy agenda.

The Brussels Effect rarely entails that the foreign targets of EU regulations willingly embrace the EU standards. Instead, foreign corporations would often prefer another rule but find it rational to adjust nonetheless given the opportunity costs of not doing so. At the same time, this dynamic is different from the EU coercing others to adopt its rules. Market forces are sufficient to create "involuntary incentives" to adjust to the rules of the strict regulator. In other words, unilateral regulatory globalization entails the dominant jurisdiction imposing an incentive to adjust, followed by reluctant emulation by market participants. Seen this way, unilateral regulatory globalization is produced through "go-it-alone power" by a dominant regulator, which leaves the adopters no choice but to adhere to the rules else forgo the opportunity to trade with Europe altogether (Gruber, 2000).

Foreign governments are similarly unenthusiastic about the EU's ability to externalize its regulations. Yet they can do little to counterbalance the EU's regulatory hegemony. Countries whose regulatory preferences are overridden by the EU's standards gain nothing by entering into a regulatory race with the EU—outpacing the EU will only leave them with even higher, and hence less desirable, regulatory standards. They also have only an imperfect ability to dampen the EU's regulatory ambitions with sanctions or by resorting to international institutions. This makes them passive spectators of the process where the markets are unleashed to spread the EU norms and entrench them in global markets.

Given the limited ability of foreign governments or international institutions to constrain the EU's regulatory agenda, the greatest check on the EU's regulatory powers comes from within the EU itself. As the EU's powers grow, internal divisions within the EU will increase. The ongoing euro crisis further fuels resentment among the European people, contributing to a severe political backlash. This may eventually lead to a repatriation of some regulatory powers from Brussels back to the Member States. Thus, the EU's own evolving conception of the limits of its regulatory authority will, in the end, define the boundaries of its regulatory reach.

While focusing on the ability of the markets to transform EU standards into global standards, this Article does not claim that the

[4] Some examples of the race to the bottom phenomenon however remain. *See* Millimet, D. & List, J. (2004). The Case of the Missing Pollution Haven Hypothesis, *J. Reg. Econ.*, 26(3), 239–262.