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# The Development of European Economic Constitution and Its Roles in Regulating the Common Market

## —With Free Competition and Free Movements as an Example

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**The Development of European Economic Constitution and its roles in regulating the common market—with free competition and free movements as an example**

Dr. Li Jingkun

## Introduction

As early as in the 19th century the term 'economic constitution' could be found in the scholars' works[1]. However, it wasn't accepted widely until the mid of 20th century and was put into practice for the first time in the constitution of the Republic of Weimar. Nowadays the 'economic constitution' has already received broad acknowledgement as a category of constitutional studies in western countries, whose basic theoretical framework is in the process of being formed. [2] But to the concept of 'economic constitution', no one definition that has got uniform recognition exists until today. Generally speaking, it refers to the "sum of the laws and institutional arrangements regulating economic activities".[3] Of course this definition appears a little too generalised, while the definitions of the following two German scholars look more detailed and precise. W. Fikentscher pointed out that "the economic constitution, in a cotemporary sense, is constituted by the sum of constitutional and other fundamental legal provisions ……which regulate the fundamental relationships of the economy, the state and its citizens."[4] This definition bears some similarities with what is given by M. Linck, who stated that the economic constitution is "the fundamental legal rules and constitutional norms pursuant to which the state defines the scope of economic freedoms, conducts monitoring or economic regulations." [5] These two definitions also hold true in the context of the EU, where what the economic constitution regulates is not the economic activities and relationships within one state but those with trans-national nature.

In the whole process from the initial European Coal and Steel Community well into a European Union encompassing 27 member states, the economic integration is always the single most significant driving force behind the European integration. Compared with other fields, it is also the economic area that witnesses the most developed and deep-going intensity of integration, which has been reflected prominently by the smooth operation of the common market. However, as is well-known, although the market itself owns systemic mechanisms of self-regulation and self-control, it at the same time possesses some shortcomings which are difficult to overcome by itself. Therefore, in order to make the market running in a well-ordered manner it is indispensable, to a large extent, for the activities of market actors to be regulated and administered by the public authorities in accordance with the constitution and

laws. There is no exception as to the EU. In addition, since the EU is a "market without state", it becomes a more complicated problem than in a single nation state. To resolve this dilemma, the European Community/European Union has, from its very beginning, established the central position of law in the integration process and relied heavily on its legal system to regulate the common market. Furthermore, the European Court of Justice has gradually endowed the basic Treaties with functions of a "constitution". And according to the above-mentioned definitions on the "economic constitution", these laws regulating the activities and relationships of various actors (including both the relationships between public authorities and private actors and those among private actors) in the common market can be named generally the "European economic constitution".

It is impossible for us to avoid the practice and theories of Germany in studying the European economic constitution, especially the ordo-liberalism (the economic constitution theory) of the so-called Freiburg School. Since it is generally believed that[6] although the term "economic constitution" is not first coined by the Freiburg School, it is just this School that breathed a new life to the economic constitution with its special analytical and interpretative framework. In particular, by providing the law regulating economy with a constitutional status the Freiburg School enabled it to have obtained the same supreme status as a political constitution.

## The ordo-liberalism and European Economic Constitution

### 1. Ordo-liberalism

The odro-liberalism, also called liberal-ordolism by some, is the major theoretical system founded by the Freiburg School, represented by the economist Walter Eucken and two jurists Franz Böhm and Gro β mann-Doerth, all of whom had taught in the University of Freiburg of Germany. It was formed preliminarily after the failure of the Weimar Republic and evolved into a formal theoretical system and exerted decisive influences on the development of Germany's market economy after the Second World War.

In 1932 and 1933 Walter Eucken and Franz Böhm published *Staatliche Strukturwandlungen* and *Wettbewerb und Monopolkampf* respectively, symbolising the initial formation of their theoretical system. But in view of the historical conditions at that time, it was impossible for such concepts as order and freedom that they proposed to be spread and accepted widely. Only after the end of the Second World War did the "economic constitution" attract great concerns from various circles, especially during the debates on Germany's forthcoming Basic Law, the focus of which was whether a constitution should be legally binding as to some special economic model. At the same time, the

ordo-liberalism of the Freiburg School became mature and a relatively comprehensive theoretical system thus came into shape.

The ordo-liberalism[7] inherits, to a large extent, the major ideas of classical liberalism, while at the same time it widens the visions of the latter and revises some of its thoughts. In particular, it has "located the analysis of economic phenomena within the political-legal context. The use of legal languages adds a 'constitutional' element to their exploration on economic issues." Therefore, it has overthrown the central idea of classical liberalism that economics be separated from legal and political sciences. It believes that it is the political constitution that determines ultimately the "economic constitution", while the characteristics and efficiencies of the economy are dependent on its relationships with politics and law. The concept of economic constitution is the major instrument used by the Freiburg School to integrate its legal and economic ideas, combining the perspectives and rhetoric of both law and economics and thus defining the direction for its overall work[8].

The ideas of ordo-liberalism are constituted chiefly of the following points.

First, the starting point of the ordo-liberalism is to protect all-around personal freedoms, including not only the political but economic ones, since the political freedom itself is far from enough to guarantee the economic freedoms of all members of society. In fact, the economic freedom is one of the fundamental factors of the political freedom, whose importance has been usually ignored. Therefore, it is indispensable to protect the overall individual freedoms both in political and economic fields.

Second, in view of the first point, it is of central significance to protect free competition, because monopoly will lead to the concentration of private economic powers, thus hindering the economic freedoms of other market actors. Only an economy of free competition can be regarded as the best economic mode, because it is the important channel by which to realize economic prosperity and social justice and also the foundation of a state to maintain political democracy and freedom. That all competitors have equal opportunities is the precondition of the success of market economy. Competition is not only a tool by which to realize such economic objectives as growth and efficiency, but more of a procedure to contain private economic powers.

The third point is about the relationships between state and market. Market is necessary but imperfect. Therefore, it is inevitable for the state to be entrusted with a special function as a warrantor of the market. In order to protect individual freedoms, the state has the responsibility to establish a market order maintaining free competition, and the state practising "laissez - faire" policies

should be substituted by a “strong state”, where the economic system must be protected by the public authorities. However, a state should in no way guide the economic processes, but on the contrast, set up a competitive system based on the self-determination of economic actors. In view of this, we can see that as to the relationships between state and market, what the Freiburg School seeks for is a “middle way” between central planned economy and the laissez-faire liberalism with unrestrained freedoms.

The last but not the least important point is about the pivotal role that law plays. In a market economy with free competition, law (economic constitution) has such a role that no other institutions are able to replace. The roles of the law lie on the one hand in its “fixing” the market into the framework of the constitution so as to prevent competition from being distorted and to ensure the benefits from market to be distributed equally to the society, while on the other hand in its preventing governmental powers to encroach the citizens’ rights and to guarantee a “limited government” by minimizing the government’s intervention into economy. Hereby, the Freiburg School connects the constitutional organically with the economic order and law has herewith become an indispensable part of market.

In sum, the ordo-liberalism focuses on the idea that a competitive economic system is the precondition to construct a prosperous, free and just society. However, only after incorporating the market into a “constitutional framework”, can such a society be developed. Law not only protects economic freedoms but helps to realize social justice and solidarity, and competition law just lies at the heart of this plan.[9]

The ordo-liberalism provided important theoretical basis for the German government in formulating its policies after the Second World War. It in particular exerted far-reaching influences on the development of Germany’s competition law. Furthermore, it has had positive effects on the evolution of European economic constitution and especially on that of European competition law.

## 2. **Ordo-liberalism and European economic constitution**

It is well-known that the driving forces behind the European integration are peace and prosperity, but not ordo-liberalism. However, the latter provided the European common market “a set of complete and theoretically founded system of ideas, enabling the general political objectives to have possessed legal and political formalities”[10]. Its impacts on the European economic constitution are reflected mainly in the following aspects.[11]

Firstly, the Freiburg School has affected the ideologies of the politicians and

intellectuals in Europe especially by their ideas. After the World War II, the ordo-liberalists like Eucken and Bohm frequently delivered lectures in other European countries and the USA, spreading the ordo-liberal ideas. Under their influences, an increased number of intellectuals and politicians began to discuss and gradually accepted the ordo-liberalism, especially in France, Italy and Switzerland. And in turn many politicians including the former French Prime Minister Raymond Barre, had transformed their ideas into policies and laws after they came into power. It is by this way that the ordo-liberal ideas were spread all over Europe, exerting intellectual influences on the theoretical foundations of the future European integration process.

The second one is its practical influences. At the founding time of the European Community, the concept and practice of the social market economy dominated Germany, whose theoretical sources rested mainly with the ordo-liberalism. Therefore, some privileged personages in Germany, including Walter Hallstein, the first President of the Commission and member of the Ordo-liberal school, Hans von der Groeben, one of the drafters of the Spaak Report and Müller-Armack, one of the promoters of the concept of social market economy, who had exerted great influences on the formation of the European Community's economic policies when working in the German government, generally identified with the thoughts of ordo-liberalism, who in turn played critical parts in the policy formation at the initial stage of the EC.

Thirdly, some core ideas that run through the whole process of European integration coincide exactly with the ordo-liberalism, the most important of which include economic freedoms, a model of an open market economy with free competition, the key role of law in European integration, the constitutional status of the economic constitution, and a competition law as one of the indispensable parts of the economic constitution. The reason is that, "the ideas of ordo-liberalism adapt perfectly to pursuing the objectives of European integration by establishing a common market. For instance, this task demands to set up a new community centred on market economy, which coincides with the central aim of ordo-liberalism. This community should be founded on voluntary contracts, which can play a role similar to that played by the idea of economic constitution in ordo-liberal thoughts. Therefore, it can be said that the system of ideas of ordo-liberalism can be used directly to solve the issues of this 'new' Community"[12].

Fourthly, the ordo-liberalism has special significance to the developments of EU competition law. In 1957, Germany promulgated the first modern competition law in Europe, to which the ordo-liberalism had made great contributions. It is just because of the ordo-liberalism that makes competition law obtain a core position of economic constitution in Germany, while in the legal systems of most of the countries, it is impossible for competition law to be

entrusted with such a constitutional position. Germany's practice of competition law dedicated a lot to incorporating the competition law into the Treaty of Rome and thus conferring it a constitutional nature. Furthermore, some detailed provisions of EU competition law, such as those on dominant market position, came directly from German competition law, but not from American antitrust law.

## European Economic Constitution: Formation and Development

### 1. Introduction

The European economic integration consists both positive measures – those eliminating obstacles to integration -- and negative measures, that is, those coordinating the laws and regulations of member states and promoting integration. Because "when a treaty of economic integration includes a certain degree of positive integration, people can regard it as some kind of economic constitution"[13], we can take the set of basic treaties of the EU (and some secondary legislations and case laws of the ECJ) as its economic constitution, i.e. the European economic constitution.

The European economic constitution takes as its aim to guarantee the realization, smooth functioning and integration of the common market. It covers a wide range of contents such as free competition, free movements, economic and monetary union and common commercial policy. In addition, the European economic constitution touches upon transportation, industrial policy, environment protection and consumer protection, whose two key principles are free competition and free movements of the factors of production within the EU, the instruments to realize which are competition law and legislations related to free movements.

The basic structures and principles originate from the relative provisions of the basic Treaties, whose core objective is, as postulated by the basic treaties, to set up "an open market with free competition". Of course, maybe some important secondary legislations and case laws of the ECJ should also be incorporated into the European economic constitution (it is especially so to competition law), although scholars' opinions diversify as to this.

Some principal ideas of the European economic constitution include open market, protection of economic freedoms, guaranteeing of undistorted competition and construction and maintenance of market economic order by law.

At present, there still exist debates as to whether the basic treaties can be treated as a "constitution", however, its status as an economic constitution is

unshakable, just as once pointed out by the ECJ that certain aspects of the economic constitution are unchangeable, not even by treaty amendments.[14]

## 2. Formation and Developments of the European Economic Constitution

Up till now, the basic treaties that can be treated as European economic constitution include mainly the 1957 Treaty of Rome, 1987 Single European Act, 1992 Treaty of Masstricht, 1997 Treaty of Amsterdam, 2001 Treaty of Nice and the Treaty of Lisbon. It is the first three treaties that have concrete meanings from the point of view of European economic constitution. [15] In addition, we must add the Treaty of Lisbon, which entered into force in December 2009.

The Treaty of Rome is the first economic constitution designed for the European common market, which establishes a series of economic objectives including a harmonious development of economic activities, sustainable and balanced expansion, enhanced stability and the raising of standards of life. To realise these objectives, the Treaty of Rome lays down a series of instruments, all of which are included in Art. 3 and the most important of which are: 1, the Customs Union and the “four free movements”, providing that the Community has the responsibility to eliminate the customs duties and non-customs tariffs and obstacles to free movements of goods, persons, service and capital; 2, free competition, aiming at establishing “a system ensuring that competition in the internal market is not distorted”; 3, the set of common policies such as common trade policy and common transportation policy. It can be seen that the most important economic constitutional principles set up by this Treaty include opening the member states’ economy, free movements, undistorted competition and non-discrimination, and etc.

The Single European Act is one of the important steps in the development of European economic constitution. It is well-known that based on the 1988 White Paper, this Act is aimed at completing an internal market. Hereby, this Act gives a definition of “internal market” (which was referred to as “common market” in the Treaty of Rome), that is, “the internal market should include an area without internal frontiers, within which the free movements of goods, persons, service and capital will be guaranteed according to the provisions of this Treaty,” thus further laying particular emphasis on the significance of the four “free movements”. At the same time, new trends emerged as to the competition law, whose focus changed from market failure to market regulation,[16] from the control of private anti-competitive actions to state activities with such effects and state aid. In addition, the scope of the common policies has been extended to include technologies and researches and developments, economic and social cohesions, and so on. What is more important is that this Act adds contents concerning economic and monetary

cooperation, which opened the door for a “monetary constitution”. At last, this Act formally admitted the principle of “mutual recognition”.

The achievements of the Treaty of Masstricht lie not only in creating a “European Union”, but in signifying a further important progress of European economic constitution, which is reflected most prominently in two aspects. Firstly, it clearly requires that the member states “in adoption of an economic policy which is based on the internal market and on the definition of common objectives”, should conduct in accordance with the principle of an open market economy with free competition. Secondly, the Treaty of Masstricht introduces the concept and mechanism of an “economic and monetary union”, thus further perfecting the European economic constitution by incorporating the provisions about a “monetary constitution” into it. In addition, the competences of the EC were expanded again by the Masstricht Treaty into education, vocational trainings, culture, public health, consumer protection and pan-European networks, which at the same time enhances its interventions in and coordination of social policies.

Little concrete progresses have been achieved in the Treaty of Amsterdam and the Treaty of Nice concerning the European economic constitution, which will not be described in detail.

The Treaty Establishing a Constitution for Europe[17] is one of the efforts dedicated to reforming the EC/EU in order to adapt to the EU’s further enlargement. Although it wasn’t put into effect, many of its provisions have been succeeded by the Treaty of Lisbon. Although no abrupt change has been made as to the provisions concerning economic constitution, which still centres around the principles of free movements and of free competition, it defines for the first time in the history of the European integration the economic model that the EU should follow, that is, “a highly competitive social market economy”[18], thus constitutionalising the model of a “social market economy”[19]. It can be seen that it contains more precise provisions on the economic model than the “open market economy with free competition” established by the Treaty of Masstricht.

## Free Competition and Free Movements—Regulating the Common Market by the European Economic Constitution

### 1. Free competition and European competition law

As stated before, due to, in a large degree, the influences of the Freiburg School and of the German competition law, the founding fathers of the European integration conferred a constitutional status on the principle of free

competition. As can been seen, the Treaty of Rome has, from the very start, endued an unshakable foundational status to free competition, which provides the establishment of a "system ensuring the competition on the common market undistorted", and the Treaty of Masstricht has promoted further its constitutional status, which definitely put forward the concept of an "open market economy with free competition" and which widened the scopes where competition law applies.

The European competition law has the following major objectives. First, it is aimed to eliminate the territorial division and to promote the integration of the European market, so as to further the development of European economic integration. Second, it is dedicated to overcoming the obstacles erected by an economic structure dominated by a highly degree of private and state monopoly and to promoting economic developments and the growth of productivity. Third, it intends to help guarantee effective market results and hereby the economic profits of the common market. Fourth, it aims at ensuring the economic freedoms of the economic actors such as freedom of contract, freedom to enter and exist the market, and the rights of self-choice of the consumers, and etc., so as to comprehensively protect the individual freedoms.

In order to realize the above-mentioned objectives, the European competition law has designed a series of legal instruments, that is, Arts. 101 and 102 of the Treaty on the Functioning of the European Union. Art. 101 (1) provides that "The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which: (a) directly or indirectly fix purchase or selling prices or any other trading conditions; (b) limit or control production, markets, technical development, or investment; (c) share markets or sources of supply; (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; (e) make 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." It is true that Art. 101 (3) provides some derogations aiming at promoting technical or economic progresses. Art. 102 is about the dominant position. It points out that "any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States." It also lists some kinds of behaviours that constitute such kinds of abuses, including, (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; and (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. In addition, the Treaty also includes provisions regulating dumping behaviours and state aid. Therefore, the European competition law targets not only at the private enterprises and associations, but the member states, because "in modern society, the functions of governments to regulate economy have been strengthened and all member states have adopted some legislative and administrative measures to intervene in commercial activities, which have impacted the economic order."[20] By applying competition law equally to the governmental activities of the member states, it not only controls the private powers but limits state powers.

Based on the relative provisions of the Treaty, the EC has enacted a series of secondary legislations, mainly regulations, such as the No. 1/2003 Regulation on implementation of competition law and the No. 139/2004 Regulation on merger control, plus some of the important case laws of the ECJ, thus constituting a relatively complete system of European competition law, one of the cores of the European economic constitution. Both the provisions and regulations have direct effect. Hence if the laws of the member states conflict with these EC provisions and regulations, the latter must be applied in the fields where the EC competition law applies. This is one of the constitutional characters of EU competition law.

## 2. Free movements

As stated beforehand, the European integration started with the economic integration. To set up an integrated common market is one of the most important objectives that have been settled down from the very beginning. But to realize this objective it demands first of all the free economic transactions between member states without obstacles. Therefore it becomes critical to abolish all those obstacles obstructing the free movements of the four production factors, that is, goods, service, persons and capital. As stated in the Treaty of Rome, it is necessary for the "prohibition, as between Member States, of customs duties and quantitative restrictions on the import and export of goods, and of all other measures having equivalent effect" and for the "abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital". Although the European economic constitution has undertaken a lot of transformations during the European integration process, the status of these principles always remains the same.

In fact, the principles of free movements and competition law complement each other in regulating the common market, whose functions have many similarities. In truth, it is self-evident that one of the aims of the four free movements is just to eliminate state monopoly and realize competition in its largest possible degree. Since the realization of the four free movements will not only enable the consumers to choose the products freely, but what is more important is that "the economic actors can 'vote by foot' and choose the countries or regions whose framework conditions are most appropriate for them"[21], the member states have to implement a series of legal and institutional reforms such as the liberalization of market, simplification of tax system, choice of suitable social policies and environmental protection criteria, and so on, thus finally creating the necessary conditions for further competition between states. Of course the targets of the two principles are different with the competition law mainly at private actors and the principle of free movements chiefly at the member states, which is also an example to illustrate the complementary characteristics of them.

The regulating roles of the principle of free movements are also reflected on the following aspects. First, it ensures the fully protection of citizens' freedoms composed of, first of all, economic freedom which in turn will evolve into political freedom. Second, it prevents effectively the secession of the common market by the member states, thus promoting the integration and deepening of the common market. Third, it not only enables the EC law to be applied equally in all the member states by erecting principles like prohibition of discrimination, equal treatment and mutual recognition, but enables all the related laws and legislations concerning free movements in all member states to be equally applied to every EC country. That is to say, economic activities should not be limited because of different legislations in different member states within the whole common market.[22] Fourth, since the mutual recognition principle itself alone is not powerful enough to harmonize the technical legislations and standards, in order to further eliminate the obstacles to free movements, the EU enacted a series of directives related to approximating technical standards, thus further coordinating and harmonizing the member states' legislations and guaranteeing the integrity of common market.

Two Titles are included in Part III of the Treaty on the Functioning of the European Union concerning detailed regulations on the four free movements. Title II involves an overarching provision on the free movement of goods, consisted of customs union and prohibition of quantitative restrictions between Member States. Title IV provides for the free movements of persons, service and capital. Later on, along with the approval of relative secondary legislations and the case law of the ECJ, the principle of free movements was deepened and became more detailed and precise. In particular, in the process when the ECJ interpreted the principle of free movements through its judgments, it

conferred and deepened continuously the constitutional significance of this principle. In fact, some fundamental constitutional principles including direct effect don't originate from the very provisions of the basic treaties, but from the case law of the ECJ, many of which have direct connections with the principle of free movements. For instance, the principle of direct effect was developed by the ECJ in its judgment on the Case on *Van Gend en Loos*.

The legislations regulating the free movements of goods, persons and service have already obtained direct effect since the middle of 1960s. In view of the specific nature of capital, it was not until 1995 that the laws regulating the free movement of capital gained direct effect.

It is true that certain shortcomings still exist in the free movement principle. Except for the set of "exemplifications" set by the basic treaties, it can only regulate those activities with trans-national natures or influences, which essentially has no power at all to deal with the economic actions within one country.

## Conclusion

Market economy is an economic system ruled by law, while constitution is the cornerstone of the rule of law. The coordination by and supports from the constitutional system is indispensable for a market system to be formed and maintained.[23] Since in the process of European integration, the building and maintenance of the common market is always the driving force and one of the most important footstones, it is of key importance to construct and maintain a market without barriers and to guarantee economic freedom by the constitution. This is just the pivotal issue that the European economic constitution intends to resolve.

As the European economic constitution, the EU Treaties have established a series of constitutional principles able to regulate the relationships between the common market, member states and individuals. It combines systemically the negative with positive integration, which on one side prohibits and abolishes barriers set up by the member states against the common market, and on the other side regulates the common market by promulgating a series of policies. Free competition, free movements, monetary union and the common commercial policy constitute the fundamental cores of the European economic constitution, while the first two have developed into a comparatively matured stage and played a most significant role in the common market. Apart from their roles in guaranteeing the realisation of the common market, they also lend themselves to realising the objectives of limiting public powers (including the public authorities of both the member states and of the EU) and protecting personal freedoms (economic, social and political), thus entailing a more

deep-going content.

At last, it is worthy of being pointed out that the EU is a complex entity diversifying significantly from a nation state, therefore, although the European economic constitution has played important roles in integrating the market and regulating the legislations and behaviours of the member states, it still wants improving because many areas of the general economic policies of the EU still remain in the hands of the member states.

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